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Supreme Court of the United States

OCTOBER TERM, 1948

No. 442

HANNAH COHEN, EXECUTRIX OF THE ESTATE OF SOL. COHEN, DECEASED, AND DAVID E. COHEN, INTERVENOR, PETITIONERS,

vs.

BENEFICIAL INDUSTRIAL LOAN CORPORATION, ET AL.

No. 512

BENEFICIAL INDUSTRIAL LOAN CORPORATION, PETITIONER,

vs.

HONORABLE WILLIAM F. SMITH, A JUDGE OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITIONS FOR CERTIORARI FILED { DECEMBER 2, 1948. JANUARY 14, 1949.

CERTIORARI GRANTED FEBRUARY 28, 1949.

SUPREME COURT OF THE UNITED STATES

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IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 9567

HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, Plaintiff; DAVID F. COHEN, Intervener,

against

BENEFICIAL INDUSTRIAL LOAN CORPORATION, Defendant-Appellant,

and

O. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAUL A. SEIBOLD, Individually, Defendants.

Appeal from an Order of the United States District Court for the District of New Jersey

Appendix to Brief for Appellant Beneficial Industrial Loan Corporation—Filed December 18, 1947

[fol. 1] IN UNITED STATES DISTRICT COURT, DISTRICT OF NEW JERSEY

DOCKET ENTRIES

1943.

August

9 Complaint filed.

9 Summons issued (15 services to be made).

13 Summons returned served on Beneficial Industrial Loan Corp. by serving S. I. Lindell, Sec. & Treas. Southern Trust Co., Resident agent, on Aug. 11, 1943, filed.

16 Notice of motion and motion of David F. Cohen to intervene as a party plaintiff filed.

16 Affidavit of service of notice of motion filed.

23 Hearing on motion—no opposition—Order signed.

23 Order permitting David F. Cohen to intervene as party plaintiff filed. (Fr.)

25 Summons returned served on O. W. Caspersen, John Budd Smith, Roy E. Tucker, Everett T. Felder, Albert G. Morhart, Alfred G. Zimmerman, Fred C. Eibell and Philip Kapinas, personally, on August 13, 1943; served Paul A. Seibold, personally on August 13, 1943; served C. V. Smith by serving his wife on August 13, 1943; served Raymond V. Sheppard, personally, on August 16, 1943; served Richard K. Steinman, personally on August 19, 1943; returned not served as to E. K. Kincaid and Jackson R. Collins, filed.

September

8 Affidavit of service of order permitting David F. Cohen to intervene, filed.

16 Affidavit and notice of motion to dismiss as to Philip Kapinas, filed. (P. H. W.)

20 Stipulation and order extending time to plead etc. to Sept. 30, 1943, filed.

[fol. 2] 27 Summons issued. (2)

30 Notice of motion for summary judgment in favor of the defendants, Everett T. Felter, C. V. Smith, Albert G. Morhart, Raymond D. Shepard, Alfred G. Zimmerman, Fred C. Eibell, Richard K. Steinman and Paul A. Seibold, filed.

30 Notice of motion for more definite statement of for bill of particulars, filed.

30 Answer of Defendant Beneficial Industrial Loan Corporation filed. (H. F. & E.)

30 Notice of fixing place for trial filed. (Newark)

October

14 Notice of motion for inspection of books and affidavit in support thereof, filed.

14 Affidavit of service filed.

November

1 Notice of motion for summary judgment by certain defendants, filed.

1 Notice of motion for summary judgment by defendant Jackson R. Collins, filed.

1 Notice of motion for more definite statement or for a bill of particulars on behalf of Jackson R. Collins, filed.

3 Call of Calendar—Case marked off for term.

8 Summons returned served on Jackson R. Collings, personally on 10-9-43 and on E. L. Kincaid by serving Mrs. E. L. Kincaid on 11-5-43, filed.

8 Hearing on motion to dismiss action as to defendant Philip Kapinas.

8 Order of discontinuance as against defendant, Philip Kapinas, filed.

[fol. 3] 8 Stipulation consenting to discontinuance as to defendant Philip Kapinas filed.

8 Affidavit of Herman S. Turner filed.

8 Hearing on motion for summary judgments in favor of certain defendants. Decision reserved. Briefs to be filed in 10 days. (Smith)

8 Hearing for more definite statement or for bill of particulars. Motion granted as to #13 and #25.

8 Hearing on motion for inspection of books. Decision reserved. Briefs submitted. (Smith)

December

6 Motion for more definite statement or for bill of particulars by defendant E. L. Kincaid, and stipulation thereon filed.

6 Motion for summary judgment by defendant E. L. Kincaid and stipulation thereon filed.

1944

April

4 Call of Calendar—Case marked off for the Term.

May

19 Opinion filed. (Smith)

June

13 Notice of motion for order permitting inspection of books filed.

19 Hearing on motion for order permitting inspection of books. Motion granted. Order to be signed. (S)

24 Order permitting inspection of books filed. (S)

17 Injunction restraining plaintiff and intervener from disclosing any information obtained from records of defendant Beneficial Industrial Loan Corp., filed.

[fol. 4] Notice of motion to compel observance of order dated 6-22-44 and to extend said order to permit examination of records and acknowledgment of service filed.

October

23 Ordered hearing on motion to compel observance of order dated 6-22-44 and to extend said order to permit examination of records, adjourned to 10-30-44. (Fk)

30 Hearing on motion to compel observance of order dated 6-22-44 and to extend said order to permit examination of records—Decision reserved. (S)

30 Affidavits on motion to compel observance of an order dated 6-22-44 etc. filed.

30 Affidavit of Hyman Besser, filed.

1945

March

27 Opinion, filed (s). (Granting motion permitting the inspection of books and records coextensive with the allegations of the complaint from 1929 to 1944, inc.)

April

16 Order permitting further inspection of books and acknowledgment of service filed. (S)

July

17 Notice fixing Sept. 26, 1945 for trial sent counsel.

August

20 Consent order removing action from trial calendar of 9-26-45 filed. (Fk)

1946

January

24 Notice of motion to suggest death of plaintiff on the record and for substitution of plaintiff, and acknowledgment of service, filed.

[fol. 5] 24 Notice of motion for leave to amend complaint and acknowledgment of service filed.

28 Ordered hearing on motion to suggest death of plaintiff on the record and for substitution of plaintiff adjourned to 2-11-46. (Smith)

28 Ordered hearing on motion to amend complaint adjourned to 2-11-46. (Smith)

February

7 Hearing on motion for suggestion on record of the substitution of party plaintiff, and for permission to amend complaint. No opposition. Orders to be submitted. (Smith)

14 Order substituting plaintiff filed. (Smith)

14 Order granting leave to file amended complaint and extending time to file answers filed. (Smith)

27 Amended complaint and acknowledgment of service filed Feb. 26, 1946.

April

16 Answer of defendant Beneficial Industrial Loan Corp., filed.

16 Acknowledgment of service of a copy of answer of defendant, Beneficial Industrial Loan Corp., filed.

22 Notice of motion to dismiss, and for a more definite statement and acknowledgment of service filed.

24 Notice fixing 5-23-46 for trial sent counsel filed 4-22-46.

May

6 Ordered motion to dismiss and for a more definite statement dismissed. (Meaney)

[fol. 6] 7 Ordered hearing on motion to dismiss and for a more definite statement, adjourned to May 20, 1946. (Meaney)

20 Ordered hearing on motion to dismiss and for a more definite statement, adjourned to 6-3-46. (Meaney)

29 Notice of motion for order to take depositions of witnesses and for issuance of subpoenas duces tecum, and acknowledgments of service filed.

June

3 Ordered hearing on motion to dismiss and for a more definite statement adjourned to June 5, 1946. (Meaney)

7 Hearing on motion to strike counts 4, 5, 6, 7 and 9 of the amended complaint and for a more definite statement.

Ordered 4th and 5th counts of the amended complaint, amended. Decision reserved.

7 Hearing on motion for an order to take depositions and for issuance of subpoenas duces tecum. Decision reserved. Memorandums to be submitted. (Meaney)

August

5 Notice of motion to direct plaintiff and intervener to give security to defendant Beneficial Ind. Loan Corp., and acknowledgment of service filed August 2, 1946.

19 Ordered hearing on motion to direct plaintiff and intervener to give security to defendant Beneficial Ind. Loan Corp. adjourned to 9-9-46. (Fake)

[fol. 7] September

9 Stipulation of continuance filed.

9 Ordered hearing on motion to direct plaintiff and intervener to give security to defendant Beneficial Loan Corp., adjourned to September 16, 1946. (Smith)

16 Stipulation of continuance to 9-23-46, filed.

16 Ordered hearing on motion to direct plaintiff and intervener to give security to defendant Beneficial Ind. Loan Corp., adjourned to September 23, 1946. (Smith)

23 Stipulation of continuance to 10-7-46 filed.

23 Ordered hearing on motion to direct plaintiff and intervener to give security to defendant Beneficial Ind. Loan Corp., adjourned to October 7, 1946. (Smith)

October

7 Hearing on motion to direct plaintiff and intervener to give security to defendant Beneficial Loan Corp.—Decision reserved. Briefs to be filed. (Smith)

December

9 Acknowledgment of service of copy of Memorandum filed.

19 Opinion filed 12-18-46. (Meaney) (Granting motion to dismiss 5th, 6th, 7th & 9th causes of action and denying motion to dismiss 4th cause of action.)

1947

February

25 Notice of motion by Beneficial Industrial Loan Corp. to stay proceedings filed February 24, 1947.

25 Consent order staying proceedings and extending time to answer, filed February 24, 1947. (Smith) Notice mailed.

[fol. 8] June

0 Opinion filed June 27. (Smith) (Denying motion to stay proceedings.)

October

9 Trial list (November—Meaney) mailed.

November

3 Notice of motion by Beneficial Industrial Loan Corp. for stay of proceedings and extension of time filed, with acknowledgment of service.

3 Notice of motion for entry of order denying motion for security for costs and acknowledgment of service filed.

3 Hearing on motion by Beneficial Industrial Loan Corp., for stay of proceedings and extension of time. Ordered motion granted. Order to be submitted. (Smith)

3 Hearing on motion for entry of order denying motion for security for costs. Ordered motion granted. Order to be submitted. (Smith)

17 Order denying motion for security for costs, etc., filed. (Smith) Notice mailed.

December

3 Notice of Appeal filed. (E. E. & D.)

3 Copies forwarded to Clerk, USCCA; Charles Hershenstein & Wall, Haight, Carey & Hartpence.

3 Cash in the sum of $250.00 was deposited in Registry in lieu of Bond on Appeal.

3 Stipulation as to contents of transcript of record on appeal filed.

10 Order for correction of docket entry from "June 30, 1947 Opinion, filed June 27 (Smith) (Denying motion to

stay proceedings)" to "June 30, 1947, Opinion, filed June 27 (Smith) Denying motion for security for expenses," filed. (Smith) Notice mailed.

[fol. 9] In United States District Court, District of New Jersey.

Civil Action No. 3033

Hannah Cohen, Executrix of the Estate of Sol Cohen, deceased, *Plaintiff*,

David F. Cohen, Intervener

against

Beneficial Industrial Loan Corporation, *et al., Defendants*

Notice of Motion of Beneficial Industrial Loan Corporation, Dated August 1, 1946, for Security for Reasonable Expenses, Including Counsel Fees, Pursuant to Chapter 131 of the New Jersey Laws of 1945.

To:

Wall, Haight, Carry & Hartpence, Esqs.,
Attorneys for Hannah Cohen, Plaintiff

Charles Hershenstein, Esq.,
Attorney for David F. Cohen, Intervener.

Sirs:

Please take notice that upon the annexed affidavits of Charles E. Rivers, verified the 26th day of July, 1946, Wilkie Bushby, verified the 31st day of July, 1946, and Sigurd A. Emerson, verified the 31st day of July, 1946, and upon the pleadings and all proceedings heretofore had herein, the undersigned will move this Court on the 19th day of August, 1946, at 10:30 o'clock in the forenoon of that day or as soon thereafter as counsel can be heard, at the court room of the United States District Court for the District of New Jersey, Post Office Building, Newark, New [fol. 10] Jersey, for an order (1) directing that, within

30 days from the date of service of such order upon plaintiff and intervener with notice of entry thereof, the plaintiff and the intervener give security to defendant Beneficial Industrial Loan Corporation in the amount of not less than $125,000 for the reasonable expenses, including counsel fees, which may be incurred by said defendant in connection with this action, and for the reasonable expenses, including counsel fees, which may be incurred by the other parties defendant in connection therewith for which defendant Beneficial Industrial Loan Corporation may become subject pursuant to law or to its by-laws or under equitable principles, on the ground that the said action has been instituted and maintained by the plaintiff and the intervener in the right of defendant Beneficial Industrial Loan Corporation and that the shares of the stock of defendant Beneficial Industrial Loan Corporation held by the Plaintiff and the intervener have a total stated capital value of less than 5% of the aggregate stated capital value of all the outstanding shares of Beneficial Industrial Loan Corporation's stock and do not have a market value in excess of $50,000; (2) directing that pending the deposit of said security, all proceedings in the above entitled action be stayed; and (3) granting to defendant Beneficial Industrial Loan Corporation such other and further relief as may be just and proper.

Dated, Newark, N. J. August 1, 1946.

Hood, Lafferty & Emerson, By Sigurd A. Emerson. Sigurd A. Emerson, A member of said firm. Attorneys for defendant Beneficial Industrial Loan Corporation, 744 Broad Street, Newark, N. J.

[fol. 11] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF CHARLES E. RIVERS

STATE OF DELAWARE,
COUNTY OF NEW CASTLE, ss.:

CHARLES E. RIVERS, being duly sworn, deposes and says:

1. I am the Secretary of defendant Beneficial Industrial Loan Corporation (hereinafter sometimes called "the Corporation"). This affidavit is submitted in support of the within motion.

2. The relief sought in this motion is necessary in order to protect the Corporation and its more than 16,000 stockholders against heavy loss and damage which would be sustained should it be determined by the Court that the within action has no merit. In that event, in addition to the ex-
[fol. 12] penses and counsel fees incurred by itself, the Corporation will be liable for the expenses and counsel fees of individual defendants under Article X of its By-Laws, which provides in part as follows:

"Indemnification of Directors and Officers

"The Corporation shall indemnify and hold harmless each person who shall serve at any time hereafter as a director or officer of the Corporation from and against any and all claims and liabilities to which such person shall have become subject by reason of his having heretofore or hereafter been a director or officer of the Corporation, or by reason of any action alleged to have been heretofore or hereafter taken or omitted by him as such director or officer, and shall reimburse each such person for all legal and other expenses reasonably incurred by him in connection with any such claim or liability; provided, however, that no such person shall be indemnified against, or be reimbursed for any expense incurred in connection with, any claim or liability arising out of his own negligence or wilful misconduct. The rights accruing to any person under the foregoing provisions of this Article shall not exclude any other right to

which he may be lawfully entitled, nor shall anything herein contained restrict the right of the Corporation to indemnify or reimburse such person in any proper case even though not specifically herein provided for. The Corporation, its directors, officers, employees and agents, shall be fully protected in taking any action or making any payment under this Article X, or in refusing so to do, in reliance upon the advice of counsel."

[fol. 13] Article X of the Corporation's By-Laws was duly adopted at a stockholders' meeting on March 31, 1941, and has in no way been modified or rescinded.

3. The shares of the Corporation's stock held by the plaintiff and the intervener never had a total stated capital value which exceeded 0.01¼% of the aggregate stated capital value of all the Corporation's outstanding shares and never had a market value in excess of $8,062.50. On August 9, 1943, the date of the commencement of this action, there were issued and outstanding 2,000,000 shares of common stock and 144,678 shares of prior preference stock, all without par value. At all times since the commencement of this action there have been a minimum of 2,000,000 shares of common stock, without par value, issued and outstanding. The 250 shares of common stock referred to in paragraph 5 of the amended complaint constitute all the shares of the Corporation's stock ever owned or held by the plaintiff and the intervener.

4. The facts with respect to the expenses and counsel fees to which the Corporation may be subjected in this litigation are presented in the annexed affidavit of Sigurd A. Emerson, a member of the firm of Hood, Lafferty & Emerson, Newark, New Jersey, attorneys for the Corporation in this litigation, and in the annexed affidavit of Wilkie Bushby, a member of the firm of Root, Ballantine, Harlan, Bushby & Palmer, New York City, General Counsel for the Corporation.

5. It is estimated by the above named counsel that the reasonable expenses and counsel fees to which the Corporation may be subjected in connection with this litigation, up to a final determination by the District Court, will be in the minimum amount of $125,000, and it is therefore re-

[fol. 14] spectfully requested that the plaintiff and the intervener be required to give security to defendant Beneficial Industrial Loan Corporation in such amount.

Charles E. Rivers.

Sworn to before me this 26th day of July, 1946. Leonard M. Anderson, Notary Public. My Commission Expires February 7, 1947. (Notarial seal.) (Prothonotary's Certificate attached.)

[fol. 15] In United States District Court

[Title omitted]

Affidavit of Wilkie Bushby

State of New York,
County of New York, ss:

Wilkie Bushby, being duly sworn, deposes and says:

1. I am an attorney at law and a member of the law firm of Root, Ballantine, Harlan, Bushby & Palmer, with offices at 31 Nassau Street, New York, N. Y. My firm has been general counsel for defendant Corporation since its incorporation and has, in association with the firm of Hood, Lafferty & Emerson, of Newark, New Jersey, performed all the legal services on behalf of the Corporation in relation to the within stockholders' derivative action. I am in charge of the services performed by my firm in connection with this action; and I am familiar with all the proceedings had herein and with the various corporate transactions involved.

[fol. 16] 2. This affidavit is submitted in support of the motion made by the defendant Corporation for an order directing the plaintiff and intervener to furnish the Corporation with security in accordance with the provisions of Chapter 131 of the New Jersey Laws of 1945. I have had many years experience with the litigation of large and complicated actions, including stockholders' derivative and other representative actions, and I am familiar with the reasonable value of professional services rendered in such actions.

3. I have read the affidavit of Sigurd A. Emerson, sworn to the 31st day of July, 1946, submitted in support of the

within motion. I know the facts therein set forth to be true and agree with the opinions therein expressed. I also estimate that the minimum amount of the reasonable expenses and counsel fees to which the Corporation will be subjected (that is, the reasonable expenses including counsel fees of individual defendants in the event it is determined by this Court that the within action has no merit, and also its own reasonable expenses and counsel fees) is $125,000.

Wilkie Bushby.

Sworn to before me this 31st day of July, 1946. Lillian B. Campbell, Notary Public Kings County. Kings Co. Clk's No. —, Reg. No. 255-C-7. Certificate Filed in N. Y. Co. Clk's No. —, Reg. No. 295-C-7. Commission Expires March 30, 1947. (Notary Seal.)

[fol. 17] In United States District Court

[Title omitted]

Affidavit of Sigurd A. Emerson

State of New Jersey,
County of Essex, ss:

Sigurd A. Emerson, being duly sworn, deposes and says:

1. I am an attorney-at-law and a member of the law firm of Hood, Lafferty & Emerson, with offices at 744 Broad Street, Newark, New Jersey, attorneys for the defendant Corporation in this stockholders' derivative action, in association with the firm of Root, Ballantine, Harlan, Bushby & Palmer of New York City, general counsel for the Corporation. I am in charge of the services performed by my firm in connection with this action; and I am familiar with all the proceedings had herein and with the various corporate transactions involved.

[fol. 18] 2. This affidavit is submitted in support of the motion made by the defendant Corporation for an order directing the plaintiff and intervener to furnish the Corporation with security in accordance with the provisions of Chapter 131 of the New Jersey Laws of 1945. The purpose of this affidavit is to present an estimate of the amount of

expenses and counsel fees to which the Corporation will be subjected in the event of a determination by this Court that the within action is without merit and for which amount the Corporation seeks security as protection against the loss which will be occasioned to it and its stockholders in such event. I have had many years experience with the litigation of large and complicated actions including actions against corporate directors for mismanagement and I am familiar with the reasonable value of professional services rendered in such actions.

3. The Court is, of course, familiar with the usual detail which is involved in the investigation, analysis, organization and assimilation of facts, in the research and study of questions of law, in dealing with the different types of preliminary motions and with inspections and discoveries, in the preparation of pleadings and briefs and in the steps incident to the preparation and trial of this type of case. It is, therefore, believed that a consideration of the nature of the transactions involved and the basic factors which determine the amount of legal services, rather than a voluminous mass of detail, will provide the most reliable guide in estimating the expenses and counsel fees which will be involved in the litigation of this case to a final determination.

In addition, the amount of security which courts have required in other stockholders' derivative actions will furnish a basis for determining the amount of security to which the Corporation is entitled in order to be given rea- [fol. 19] sonable protection, and the facts with respect to such other cases will be set forth herein.

4. It becomes plain, from a study of the amended complaint, from the number and nature of the proceedings which have taken place thus far and from the fact that more than three years have elapsed since the filing of the original complaint without issue having yet been joined, that this case must be classified in the upper brackets of complicated and expensive litigations.

5. This litigation relates to the business transactions of a large corporate enterprise having hundreds of subsidiary companies conducting operations in thirty-two different states. The extent of these business operations is indicated by the following facts, of which I have been informed by

the officers of the Corporation and which I believe to be true: For the period of 1937 to 1943, both inclusive, the consolidated net income before Federal taxes amounted to over $58,000,000. The aggregate amount of loans made during that period was in excess of $895,000,000, and capital and surplus amounted to approximately $40,000,000. During that period, there were more than 16,000 stockholders of the defendant Corporation.

6. The amended complaint specifically and directly questions in this litigation consolidations and/or intercorporate transactions among the following corporations: the defendant Beneficial Industrial Loan Corporation, Industrial Bankers of America, Inc., Beneficial Loan Society, Collateral Bankers, Inc., American Loan Company, the former Beneficial Industrial Loan Corporation, Beneficial Management Corporation, Beneficial Operating Bureau and Bankers National Investors Corporation; and the general allegations of the complaint involve hundreds of subsidiary corporations located throughout the United States.

[fol. 20] 7. The voluminous factual background of this litigation is well shown by the fact that the plaintiff sought and obtained an inspection and discovery of the following records of the defendant Corporation from the date of its incorporation in 1929: *All* minute books, *all* stock books, *all* stock transfer books, *all* ledgers, *all* books of account, *all* financial statements, *all* corporate resolutions and *all* cancelled corporate vouchers and stubs.

8. The amended complaint puts into the litigation transactions carried on over long periods of time, some of which go back for over 18 years; it attacks the business and capital structure of the Corporation which has been in effect for over 16 years; and it charges liability on the part of the individual defendants in amounts aggregating in excess of $100,000,000.

9. The plaintiff attacks the entire management of the defendant Corporation over the period from the date of its incorporation in 1929 to date, charging officers and directors with a conspiracy to enrich themselves at the expense of the Corporation.

10. The magnitude and expensive character of this litigation is further shown by the brief summary of the transactions involved which now follows:

A. *Beneficial Thrift Club.* The so-called Beneficial Thrift Club was the name given to an employee-benefit plan which was operated to create incentive, loyalty and responsibility on the part of the employees of the business. The operation of the plan antedated the defendant Corporation, for it was adopted by the predecessor companies which developed the business acquired by the Beneficial Industrial Loan Corporation upon its incorporation in 1929. The entire plan (which has al- [fol. 21] ways been an integral part of the Corporation's business) is charged by the plaintiff to be illegal and the rates of interest paid for the benefit of the employees are alleged to have been exorbitant and excessive. The individual defendants are alleged to be liable for over $4,000,000 by reason of the operation of this plan. (First Cause of Action)

B. *Alleged Illegal Issuance of Stock.* Plaintiff charges that the individual defendants caused the Corporation to issue to them illegally and without the payment of consideration a large number of shares of the stock of the Corporation; and alleges that the individual defendants are liable for "very substantial" amounts for the dividends and profits accruing from such stock. (Second Cause of Action)

C. *Office in Clearwater, Florida.* Plaintiff alleges that over a period of 10 years the individual defendants maintained an office in Florida for their individual convenience and benefit rather than for proper corporate purposes; and alleged that the individual defendants are liable in a "very substantial" amount. (Third Cause of Action)

D. *Salary of Clarence Hodson, II.* Plaintiff alleges that the individual defendants are liable for an amount in excess of $100,000 by reason of the payment of a salary to Clarence Hodson, II, charging that he rendered no services whatsoever to the Company. (Fourth Cause of Action)

E. *Issuance of Stock in Connection with Consolidation.* Plaintiff alleges that the individual defendants

are liable in the sum of $20,773,470 because of the issuance to them of 449,209 shares of stock as a result of the consolidation of three corporations into the defend- [fol. 22] ant Beneficial Industrial Loan Corporation; and in this connection attacks the reorganization agreements of Beneficial Loan Society, Collateral Bankers, Inc. and Industrial Bankers of America, Inc. with the *former* Beneficial Industrial Loan Corporation. (Fifth Cause of Action)

F. *Payments made to Beneficial Management Corporation.* Plaintiff attacks all the business transactions which the Corporation had with Beneficial Management Corporation, alleging that the individual defendants are liable in respect of payments made by the Corporation to Beneficial Management Corporation over the six-year period of time from 1937 to 1943 of sums of money in excess of $26,000,00. (Sixth Cause of Action)

G. *Payments made to Affiliates and Subsidiaries.* Plaintiff alleges that the individual defendants are liable for sums of money in excess of $20,000,000 paid by the Corporation to its affiliates and subsidiaries over the period of time between 1937 and 1943. (Seventh Cause of Action.)

H. *Transactions with Collateral Bankers, Inc. and Beneficial Operating Bureau.* Plaintiff alleges that the individual defendants are liable in the amount of $553,451.44 by reason of exorbitant interest rates paid to Collateral Bankers, Inc. over the period of time from 1929 to 1932 and in the amount of $308,208 by reason of excessive interest paid to Beneficial Operating Bureau over the period of time from the date of incorporation of the Corporation to the year 1931 inclusive. (Eighth Cause of Action)

I. *General Allegations.* Plaintiff alleges generally that the individual defendants, before and since the incorporation of the defendant Corporation, engaged [fol. 23] in a general conspiracy to enrich themselves at the expense of the Corporation and thereby damaged the Corporation in excess of $30,000,000. (Ninth Cause of Action)

11. The amount and expense of the legal services which will be involved in a litigation of this case to a final determination is well shown by the extent of the proceedings which have taken place even before issue has been joined. There follows a brief summary of such proceedings:

A. The original complaint was verified on or about May 29, 1943 and filed shortly thereafter.

B. On or about June 2, 1943 the plaintiff obtained a temporary restraining order restraining certain corporations named as parties in the original complaint from removing their records from the jurisdiction.

C. On or about June 6, 1943 the defendant Beneficial Industrial Loan Corporation made a motion for an order quashing the return of service of summons and dismissing the action.

D. On or about June 10, 1943 one David F. Cohen made a motion to intervene as a party plaintiff.

E. On or about July 6, 1943 motions were made by other defendants named in the original complaint for an order dismissing the action.

F. On or about the 12th day of July, 1943 a motion was made by the plaintiff for an inspection and discovery of substantially all of the books and records of the defendant Beneficial Industrial Loan Corporation.

G. On or abont August 9, 1943 this Court granted the motions of the defendants named in the original [fol. 24] complaint and dismissed the complaint without prejudice.

H. On or about August 9, 1943 a new complaint was verified and filed naming different defendants. This complaint alleged four causes of action.

I. Thereafter the defendant Beneficial Industrial Loan Corporation served an answer to the complaint setting forth relevant facts and praying that "so much of each of the complaints as demands that a receiver or receivers for defendant be appointed pending the final judgment or decree in this case and the satisfaction thereof be dismissed, and as to the balance of the relief sought in said complaints defendant submits its rights to the protection of this Court".

J. On or about the 23rd day of August, 1943 one David F. Cohen made a motion to intervene as a party plaintiff.

K. On or about October 4, 1943 a motion was made on behalf of certain of the individuals named as defendants for summary judgment on the ground that no genuine issue as to any material fact existed.

L. On or about October 4, 1943 a motion was made on behalf of the individual defendants for an order directing the plaintiff to file a more definite statement or a bill of particulars.

M. On or about October 18, 1943 the plaintiff made a motion for an inspection and discovery of substantially all of the books and records of the defendant Beneficial Industrial Loan Corporation.

N. On June 22, 1944 the Court entered an order granting an inspection and discovery of the books and records of the defendant Corporation.

[fol. 25] O. On or about August 17, 1944 on motion of the defendant Beneficial Industrial Loan Corporation this Court entered an order restraining plaintiff and intervener and their respective attorneys and accountants from disclosing to any person, firm or corporation, any information obtained from any of the books or records of the defendant Beneficial Industrial Loan Corporation.

P. On or about the 23rd day of October, 1944 the plaintiff made a motion for an order to extend the order permitting the inspection and discovery of the books and records of the defendant Corporation.

Q. On or about April 6, 1945 this Court entered an order extending the right of the plaintiff to inspect the books and records of the defendant Corporation from 1929 to 1944 inclusive.

R. Pursuant to the above-mentioned orders of this Court of June 22, 1944 and April 6, 1945, plaintiff and intervener conducted an extensive inspection of the defendant Corporation's books and records at its principal office in Wilmington, Delaware.

S. In February, 1946 an amended complaint was served alleging nine instead of four causes of action.

T. Thereafter, on or about April 15, 1946 the defendant Beneficial Industrial Loan Corporation served its answer to the amended complaint setting forth relevant facts for the information of the Court and praying that so much of the amended complaint as demands that a receiver or receivers be appointed pending the final judgment be dismissed and as to the balance of the relief sought in the amended complaint, the defendant Corporation submitted its rights to the protection of this Court.

[fol. 26] U. On or about May 6, 1946 the individual defendants named in the amended complaint made a motion to dismiss the Fourth, Fifth, Sixth, Seventh and Ninth alleged causes of action and for a more definite statement or a bill of particulars. This motion is now pending before the Court for determination.

V. On or about the 5th day of June, 1946 the plaintiff made a motion for an order to take the depositions of certain of the individual defendants and other named persons and for the issuance of *subpoenas duces tecum* ordering the production of a voluminous mass of records, documents in the possession of hundreds of different corporations. This motion is now pending before the Court for determination.

12. Thus it is clear that the Corporation is entitled to obtain security in a very substantial amount in order to obtain protection against the loss which will be suffered by it and its stockholders in the event this Court should find that the charges of the plaintiff and the intervener are unfounded. In such event, the Corporation would be liable for the expenses and counsel fees of individual defendants who are represented by Pitney, Hardin, Ward & Brennan, Newark, New Jersey and John Milton, Esq., of counsel, Jersey City, New Jersey, under Article X of its By-Laws, which is set forth in the affidavit of Charles E. Rivers submitted herewith. In addition thereto, the Corporation will be subject to the loss occasioned by the expenses and counsel fees of my firm and of Messrs. Root, Ballantine, Harlan, Bushby & Palmer.

13. In stockholders' derivative actions far less complicated than the one here involved, courts have ordered that [fol. 27] the stockholders who subjected the corporation to the risk of loss to give substantial amounts of security. In one case the court ordered the plaintiff stockholder to give security in the amount of $50,000. That case involved only a corporate bonus plan and the computation of payments made pursuant to such plan. At the time the court fixed the security of $50,000, six of the alleged causes of action had already been dismissed and only three remained involving alleged improper computation payments (*Mann* v. *Luke*, N. Y. L. J., November 10, 1944, p. 1244, col. 4 (Sup. Ct., N. Y. Co.)). In a very recent case the New York Appellate Division affirmed an order requiring the plaintiff stockholder to post security in the amount of $40,000. Here again the amount of the legal services which would be required in that action are not to be compared with the extent of such services in relation to the within action (*Baker* v. *Macfadden Publications*, 270 App. Div. 440, 59 N. Y. S. (2d) 841 (1st Dept. 1946). In another case, a plaintiff stockholder was required to give security in the amount of $25,000. All that was involved in that case was a charge by the plaintiff stockholders that payments under the corporation's profit sharing plan were improperly computed and the alleged improper accounting methods were expressly set forth in the complaint. There were no questions of fact raised by the pleadings and the case did not even remotely approach the magnitude and complexity of the litigation here involved. (*Shielcraft* v. *Moffett*, 49 N. Y. S. (2d) 64 (Sup. Ct., N. Y. Co., 1944)). In another comparatively simple case, the court also required security in the amount of $25,000. (*Noel Associates* v. *Merrill*, 184 Misc. 646, 53 N. Y. S. (2d) 143 (Sup. Ct., N. Y. Co., 1944)). I have been informed of the facts stated in this paragraph by an attorney associated with me in this action, who has examined the records in the above-mentioned cases, and I verily believe them to be true.

[fol. 28] 14. In my opinion the minimum amount of the reasonable expenses and counsel fees to which the Corporation will be subjected (that is the reasonable expenses including counsel fees of individual defendants in the event it is determined by this Court that the within action has no merit, and also its own reasonable expenses and counsel

fees) is $125,000. My estimate is confirmed and supported by the affidavit of Wilkie Bushby, submitted herewith.

Sigurd A. Emerson.

Sworn to before me this 31st day of July, 1946.
Marguerite Wilson, Notary Public of New Jersey.
My Comm. Exp. Jan 21, 1951. [SEAL.]

[fol. 29] IN UNITED STATES DISTRICT COURT, DISTRICT OF NEW JERSEY

Civil No. 3033

HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, Plaintiff,

DAVID F. COHEN, Intervenor,

against

BENEFICIAL INDUSTRIAL LOAN CORPORATION, et al., Defendants

OPINION

Smith, District Judge

This is a stockholders derivative action brought by the plaintiff on behalf of the corporate defendant and against the individual defendants, the officers and directors of the corporate defendant. The jurisdiction of the court is based solely upon the alleged diversity of citizenship.

The action is before the Court at this time on the motion of the corporate defendant to require the plaintiff "to give security for the reasonable expenses, including counsel fees, which may be incurred by it * * * and by the other parties defendant * * * for which it may become subject pursuant to law, * * * or under equitable principles." The corporate defendant asserts a right to such security under section 15, chapter 3, Title 14 of the Revised Statutes of New Jersey, R. S. 14:3-15, N. J. S. A. 14-3-15, hereinafter designated as the General Corporations Act, the pertinent provisions of which follow: "In any action instituted or maintained in the right of any domestic [fol. 30] or foreign corporation by the holder or holders of shares, or of voting trust certificates representing

shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require *the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action* and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, *to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action.* The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive." (Emphasis by the Court.)

It is the contention of the corporate defendant that the quoted statute creates a right of substantive character which must be enforced in this court under the doctrine of *Erie R. R. Co.* v. *Tompkins*, 304 U. S. 64. We cannot agree with this contention. The statute does not grant to the corporate defendant an absolute right

to counsel fees and expenses upon the successful termination of the action. The statute grants to the corporate [fol. 31] defendant nothing more than a right to require security for the payment of counsel fees and costs, their allowance to await determination by the court upon termination of the action. This right is remedial and not substantive. *Boyd* v. *Bell*, 64 F. Sup. 22, 24; See also *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491, 497.

The stockholders derivative suit is a remedy peculiar to equity and, as in other suits in equity, the jurisdiction of the court of chancery to award counsel fees and costs as between party and party, as distinguished from the right of

a party to require security for their payment, is governed by section 131, chapter 29, Title 2 of the Revised Statutes of New Jersey, R. S. 2:29-131, N. J. S. A. 2:29-131, hereinafter designated as the Chancery Act, the pertinent provisions of which are quoted in the footnote.[1] It is well established that the allowance of such fees and costs under this statute is within the sound discretion of the court of chancery, *Lane* v. *Rushmore*, 11 A 2d. 91; *Grunstra* v. *New-Ark Petroleum Corp.*, 162 A 2d 746, and the successful party is not entitled to an allowance of such fees and costs as a matter of right, *Henn* v. *Clifford J. Heath, Inc.*, 141 A. 769. The pertinent provisions of the General Corporations Act are clearly consistent with these established principles and should be so construed.

[fol. 32] The General Corporations Act neither abridged the recognized statutory jurisdiction of the court of chancery nor granted

the corporate defendant a substantive right to counsel fees and expenses inconsistent therewith. The statutory jurisdiction of the court of chancery, derived from the Chancery Act, was impliedly augmented by the General Corporations Act to permit enforcement of the remedy made available thereunder to the corporate defendant. The legislation was clearly remedial and created no right of substantive character. The discretionary power of the court of chancery to allow counsel fees and costs as between party and party is not affected by the General Corporations Act.

The right of the corporate defendant under the said

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[1] "In any cause, matter or proceeding in the court of chancery the chancellor may make such allowances by way of counsel fee to the party obtaining the order or decree as shall seem to him to be reasonable and proper, and shall direct which of the parties shall pay such allowances; or, where such allowances are ordered to be paid out of property or funds, shall specify and direct the property or funds liable therefor.

"The chancellor may provide for the inclusion of such allowances in the taxable costs, or may provide for their collection in such other manner as is agreeable to the practice of the court.

"Such allowances shall be in lieu of any allowance for counsel fees provided for by statute."

Act to require the plaintiff to give security for counsel fees and expenses as a condition precedent to the maintenance of his suit, is obviously a limitation upon the right of the plaintiff to invoke the jurisdiction of the court. This limitation, created only by state statute and enforceable in the state court, may not be enforced in the federal court. *Missouri Pacific Ry. Co.* v. *Larabee*, 234 U. S. 459, 471; *Orlando Candy Co.* v. *New Hampshire Fire Ins. Co.*, 51 F. 2d 392, 393, and other cases hereinafter cited.

This remedy, although available to the corporate defendant in the state courts, may not be enforced in this court. It is well established that new equitable rights of substantive character created by state statute may be enforced by the federal courts, the jurisdictional requirements being present, *Guaranty Trust Co.* v. *York*, 326 U. S. 99, but it is equally well established that the equity jurisdiction of the federal courts to enforce such rights may not be limited or impaired by state statute, *Matthews* v. *Rodgers*, 284 U. S. 521, 529; *Henrietta Mills* v. *Rutherford County*, 281 U. S. 121, 127; *Pusey & Jones Co.* v. *Hanssen*, 261 U. S., 491, 497, [fol. 33] *Mason* v. *United States*, 260 U. S. 545, 557; *Mississippi Mills* v. *Cohn*, 150 U. S. 202, 205; *Dodge* v. *Tulleys*, 144 U. S. 451, 457; *Purcell* v. *Summers*, 145 F. 2d 979, 990; *Black & Yates* v. *Mahogony Assn.*, 129 F. 2d 227, 233. Neither the equity jurisdiction of the federal courts nor the right of the litigant to invoke it may be abridged by state legislation.

The apposite principles determinative of procedural conflicts were succinctly stated by Justice Frankfurter in the case of *Guaranty Trust Co.* v. *York*, supra, at page 105: "This does not mean that whatever equitable remedy is available in a State court must be available in a diversity suit in a federal court, or conversely, that a federal court may not afford an equitable remedy not available in a state court. Equitable relief in a federal court is of course subject to restrictions: the suit must be within the traditional scope of equity as historically evolved in the English Court of Chancery, Payne v. Hook, 7 Wall. 425, 430; Atlas Ins. Co. v. Southern, Inc., 306 U. S. 563, 568; Sprague v. Ticonic Bank, 307 U. S. 161, 164-165; a plain, adequate and complete remedy at law must be wanting, §16, 1 Stat. 73, 82, 28 U. S. C. §384; explicit Congressional curtailment of equity powers must be respected, see, e.g., Norris-LaGuardia Act, 47 Stat. 70, 29 U. S. C. §101 et seq.; the constitutional right

to trial by jury cannot be evaded, Whitehead v. Shattuck, 136 U. S. 146. That a State may authorize its courts to give equitable relief unhampered by any or all such restrictions cannot remove these fetters from the federal courts. See Clark v. Smith, supra at 203; Broderick's will, 21 Wall. 503, 519-20; Louisville & Nashville R. Co. v. Western Union Co., supra at 376; Henrietta Mills v. Rutherford Co., 281 U. S. 121, 127-128; Atlas Ins. Co. v. Southern, Inc., supra, at 568-70. State law can-

not define the remedies which a federal court must give simply because a federal court in diversity jurisdiction is [fol. 34] available as an alternative tribunal to the State's courts. Contrariwise, a federal court may afford an equitable remedy for a substantive right recognized by a State even though a State court cannot give it. Whatever contradiction or confusion may be produced by a medley of judicial phrases severed from their environment, the body of adjudications concerning equitable relief in diversity cases leaves no doubt that the federal courts enforced State-created substantive rights if the mode of proceeding and remedy were consonant with the traditional body of equitable remedies, practice and procedure, and in so doing they were enforcing rights created by the States and not arising under any inherent or statutory federal law."

There have been cases in which the federal courts have recognized and enforced, as a right substantive in character, the right of the successful plaintiff to recover attorneys fees and costs. *Sioux County* v. *National Surety Co.*, 276 U. S. 238; *Home Life Ins. Co.* v. *Fisher*, 188 U. S. 726; *Iowa Life Ins. Co.* v. *Lewis*, 187 U. S. 335; *Fidelity Mutual Life Assn.* v. *Mettler*, 185 U. S. 308. The cases cited by the corporate defendant in its brief are in this category. *Associated Manufacturers Corp.* v. *De Jong*, 64 F. 2d 64; *Pond* v. *Goldstein*, 41 F. 2d 76; *Business Men's Assur. Co.* v. *Campbell*, 18 F. 2d 223. The cited cases, however, are easily distinguishable from the present case. It will be observed that in each of these cases the liability of the defendant for attorneys fees and costs was a statutory liability assumed by the defendant under contract, and the right of the plaintiff to their recovery was absolute; the allowance of attorneys fees and costs was not within the discretion of the court, but their

award as an element of damage was mandatory. Ibid. These were important differentiating factors and were so regarded by the courts.

[fol. 35] There have been other cases in which the historic equity jurisdiction of the federal courts to allow attorneys fees and costs as between solicitor and client has been sustained as inherent. *Sprague* v. *Ticonic Bank*, 307 U. S. 161; *Central Railroad* v. *Pettus*, 113 U. S. 116; *Trustees* v. *Greenough*, 105 U. S. 527; *Lamar* v. *Hall & Wimberly*, 129 Fed. 79. These cases are likewise easily distinguishable from the present case. It will be observed that in each of the cited cases, as well as in many others not cited, attorneys fees and costs were assessed against the beneficiaries of the litigation pursuant to commonly accepted equitable principles. Ibid.

The present case is governed by the Federal Rules of Civil Procedure promulgated by the Supreme Court pursuant to Sections 723(b) and 723(c) of Title 28 U. S. C., 28 U. S. C. A. 723 (b) and 723 (c). There is nothing therein which permits the allowance of "counsel fees and expenses" as between party and party; in fact, Section 571 of Title 28 U. S. C., 28 U. S. C. A. 571, as construed by the courts, prohibits such allowances in the absence of express statutory authority. *Tullock* v. *Mulvane*, 184 U. S. 497, 511; *Oelrichs* v. *Spain*, 15 Wall. 211, 230; 82 U. S. 211, 230; *McIntosh* v. *Ward*, 159 Fed. 66, 68; *Farmers' Loan & Trust Co.* v. *Green*, 79 Fed. 222, 225; Cf. *Gold Dust Corp.* v. *Hoffenberg*, 87 F. 2d 451, 453; *Marks* v. *Leo Feist, Inc.*, 8 F. 2d 460. It seems reasonably clear that under the Federal Rules of Civil Procedure the recoverable costs are limited to the ordinary taxable costs. It would be

obviously futile to require the plaintiff in the instant case to give security for the payment of "counsel fees and expenses" if, as the cases seem to hold, there is no jurisdiction in the court to allow them upon termination of the suit.

The contention that the General Corporations Act created a right substantive in character, if adopted, will not avail [fol. 36] the corporate defendant. The said defendant is admittedly a corporation of the State of Delaware, and it necessarily follows that the law of Delaware is determinative not only of the liability of its officers and directors but

also of the rights of stockholders. *Prudential Ins. Co. of America* v. *Carlson*, 126 F. 2d 607, 611; *Gallup* v. *Caldwell*, 120 F. 2d 90. The liability of the corporate defendant for counsel fees and expenses may be charged against the plaintiff stockholder, upon the successful defense of the stockholders derivative action, only if such fees and expenses are recoverable as a matter of right under the laws of Delaware.

The constitutionality of the General Corporations Act is challenged by the plaintiff, and this challenge may not be without merit. See *Zlinkoff, The American Investor and the Constitutionality of Section 61-B of the New York General Corporation Law*, 54 Yale L. J. 352; compare *Myer* v. *Myer*, 296 N. Y. 979. We see no reason, however, to consider the constitutional questions raised in the plaintiff's brief.

The motion is denied.

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[fol. 37] In United States District Court, District of New Jersey

Civil Action No. 3033

Hannah Cohen, Executrix of the Estate of Sol Cohen, deceased, Plaintiff,

David F. Cohen, Intervener,

against

Beneficial Industrial Loan Corporation, *et al.*, Defendants.

Order on Motion for Security for Expenses

This matter coming on to be heard before the Court on motion of the defendant Beneficial Industrial Loan Corporation for an order, pursuant to Sections 15 and 17, Chapter 3, Title 14 of the Revised Statutes of New Jersey, directing the plaintiff and the intervener to give security for the reasonable expenses, including counsel fees, which may be incurred by said defendant in connection with this action, and for the reasonable expenses, including counsel fees, which may be incurred by the other parties defendant in connection therewith for which defendant Beneficial Indus-

trial Loan Corporation may become subject, and Hood, Lafferty and Emerson, Esqs., now Emerson, Emery and Danzig, Esqs., by Sigurd A. Emerson, Esq., appearing on [fol. 38] behalf of the said motion, and Wall, Haight, Carey & Hartpence, Esqs., by Edward J. O'Mara, Esq., and Charles Hershenstein, Esq., appearing in opposition to said motion, and the Court having heard and considered the arguments of counsel and having read and considered the memoranda presented by counsel in support of their positions, and being of the opinion that said motion should be denied; and application having been made by Beneficial Industrial Loan Corporation on November 3, 1947, for a stay pending an appeal or other review of the denial of said motion for security for expenses:

Now, it is on this 17th day of November, 1947

Ordered, that the said motion of defendant Beneficial Industrial Loan Corporation, for security for expenses be, and the same hereby is, denied; and it is further

Ordered, that all proceedings in this action shall be, and hereby are, stayed for ninety (90) days from the date hereof pending an appeal or other review of the denial of the motion for security for expenses in the Circuit Court of Appeals for the Third Circuit, provided that a notice of appeal or any other petition for review of this order is filed by the defendant Beneficial Industrial Loan Corporation not later than twenty days after the entry of this order; and it is further

Ordered that in the event the situation of the plaintiff and the intervener changes, they or either of them may apply on five (5) days' notice for a modification of the stay herein ordered.

Dated: November 17, 1947.

William F. Smith, U. S. District Court Judge.

[fol. 39] We hereby consent to the entry of the foregoing order.

Pitney, Hardin, Ward & Brennan, Attorneys for defendants O. W. Caspersen, John Budd Smith, Roy E. Tucker, Everett T. Felter, Jackson R. Collins, C. V. Smith, E. L. Kincaid, Albert G. Morhart, Raymond D. Shepard, Alfred G. Zimmerman, Fred C. Eibell, Richard K. Steinman and Paul A. Siebold. Waldon M. Ward, Of Counsel for the above named defendants.

[fol. 40] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 9558

HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, Plaintiff; DAVID F. COHEN, Intervener,

against

BENEFICIAL INDUSTRIAL LOAN CORPORATION *et al.*, Defendants.

In the Matter of the Application of Beneficial Industrial Loan Corporation for a writ of Certiorari or for a Writ of Mandamus

MOTION FOR RULE TO SHOW CAUSE

To the Honorable the Judges of the Circuit Court of Appeals of the United States for the Third Circuit:

Now comes Beneficial Industrial Loan Corporation and moves, upon the showing made by the accompanying petition for a writ of certiorari or for a writ of manadmus, that a rule be entered and issued directing the District Court of the United States for the District of New Jersey and the Honorable William F. Smith, a judge thereof, to show cause why a writ of mandamus should not issue against them, in accordance with the prayer of said petition, and why Beneficial Industrial Loan Corporation should not have such other and further relief as may be just.

Dated December 5, 1947.

Charles Danzig, Emerson, Emery & Danzig, Attorneys for Beneficial Industrial Loan Corporation, 744 Broad Street, Newark 2, New Jersey.

[fol. 41] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 9558

[Title omitted]

PETITION FOR WRIT OF CERTIORARI OR MANDAMUS

To the Honorable the Judges of the Circuit Court of Appeals of the United States for the Third Circuit:

Your petitioner, Beneficial Industrial Loan Corporation (herein sometimes referred to as "the Corporation"), respectfully shows as follows:

1. On August 9, 1943, there was filed in the United States District Court for the District of New Jersey by Sol Cohen, as the holder of 100 shares of the outstanding 2,000,000 shares of common stock of the Corporation, a derivative stockholder's action in the right of the Corpora- [fol. 42] tion against certain directors of the Corporation and others. Under the rules governing such actions, the Corporation was named and served as a nominal party defendant. On August 23, 1943, David F. Cohen, as holder of 150 shares of the Corporation's common stock, intervened as a party plaintiff.

2. Pursuant to orders of the District Court dated June 22, 1944, and April 6, 1945, the plaintiff and intervener, through their accountants, conducted an extensive inspection of the Corporation's books and records.

3. On February 14, 1946, Hannah Cohen, executrix of the estate of Sol Cohen, deceased, was substituted as plaintiff in the place of Sol Cohen, deceased. On February 16, 1946, an amended complaint was filed, alleging nine causes of action against certain directors of the Corporation and others. The amended complaint attacked the management of the Corporation for alleged misconduct and waste of the corporate assets over a period of more than sixteen years, and alleged that the individual defendants were liable for amounts in excess of $100,000,000.

4. The Corporation served answers to both the original and the amended complaint, setting forth relevant facts and, as a mere formal party, submitting its rights to the

protection of the Court. The individual defendants have not yet filed an answer, their time to do so being still open.

5. On motion of the individual defendants dated April 16, 1946, the District Court dismissed four of the causes of action alleged in the amended complaint on the ground that they failed to state a claim on which relief can be granted. The causes of action so dismissed related to transactions in an amount of over $96,000,000. The decision of the District Court is reported in 69 F. Supp. 297.

[fol. 43] 6. On August 1, 1946, your petitioner made a motion for an order requiring the plaintiff and intervener to give security to petitioner in the amount of $125,000 for the reasonable expenses, including counsel fees, which may be incurred by petitioner in connection with the action, and for the reasonable expenses, including counsel fees, which may be incurred by the other parties defendant in connection therewith, for which the petitioner will be liable in the event it is held that the action against the individual defendants is without merit. True copies of your petitioner's notice of motion and the three affidavits submitted in support thereof are annexed hereto, marked "Exhibit A," "Exhibit B," "Exhibit C" and "Exhibit D," respectively.

7. The said motion is based on Chapter 131 of the New Jersey Laws of 1945. Sections 1 and 3 of Chapter 131 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17) provide as follows:

> "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the

[fol. 44] reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive.

"This act * * * shall take effect immediately and shall apply to all such actions, suits or proceedings now pending in which no final judgment has been entered, and to all future actions, suits and proceedings."

8. It is not disputed that all requirements of the statute are satisfied. The shares held by the plaintiff and intervener never exceeded 0.01¼% of the ou-standing shares of its capital stock and never exceeded a total market value of $9,000.

9. The motion was argued before Honorable William F. Smith, United States District Judge, on October 7, 1946. Thereafter, on June 27, 1947, District Judge Smith filed an opinion and decision, wherein for reasons stated he denied the motion. A true copy of said opinion and decision is annexed hereto, marked "Exhibit E." In the opinion he held that Chapter 131 of the New Jersey Laws of 1945 is procedural in nature and not binding on the Federal District Court.

[fol. 45] 10. On November 17, 1947, an order was entered on said opinion and decision, denying the motion of your petitioner for security for expenses and counsel fees. A true copy of said order is annexed hereto, marked "Exhibit F."

11. On December 3, 1947, your petitioner filed a notice of appeal to this Court from the order of the District Court. Your petitioner believes that the said order is a final decision within the meaning of section 128 of the Judicial Code

(36 Stat. 1133, 28 U. S. C. §225), as amended, for the reasons set forth in the brief accompanying this petition. A writ of certiorari or mandamus is sought only in the event that it should be determined that no direct appeal to this Court lies from the order of the District Court.

12. Petitioner submits that the New Jersey statute here involved is binding on the Federal District Court sitting in New Jersey and that the District Court erred in denying petitioner's motion. Petitioner further claims that the action of the United States District Court for the District of New Jersey, in denying the motion of your petitioner for an order requiring the plaintiff and intervener to give security pursuant to Chapter 131 of the New Jersey Laws of 1945, and in refusing to fix a reasonable amount for such security, is entirely without warrant of law and is not a matter within the judicial discretion of the District Court.

13. The order sought to be reviewed denies to your petitioner a very substantial right. The statute invoked was enacted in order to protect corporations and their stockholders from the losses which they will otherwise suffer as a result of expenses and counsel fees in connection with the litigation of derivative stockholder's suits in the event it is determined that the causes of action asserted therein [fol. 46] have no merit. The fact that in the instant action four of the alleged causes of action, involving transactions in the amount of more than $96,000,000, have already been dismissed on the merits exemplifies concretely the obvious risk of substantial loss to which a corporation is subjected by the institution of a derivative action in its right. Pursuant to Article X of its by-laws, as adopted at a stockholders' meeting on March 31, 1941, the Corporation will be liable to the individual defendants for the reasonable expenses, including counsel fees, incurred by them in their successful defense against the four alleged causes of action which the Court dismissed on the merits. Unless the Corporation can obtain reimbursement under the New Jersey statute from the plaintiff and intervener who took it upon themselves to assert claims on behalf of the Corporation, found by the Court to be without merit, and thus subject it to this liability, this substantial loss will have to be borne by the Corporation and its stockholders, 99.9% of whom had nothing to do with, but were powerless to prevent, the assertion of these unfounded claims. Unless

they obtain the protection provided for such cases by Chapter 131 of the New Jersey Laws of 1945, their losses will be much more serious if this action is litigated to a final determination, in case the remaining causes of action are also found to be without merit.

14. Unless the order of the District Court is reviewed prior to its final disposition of the action, the Corporation will be denied any review at all. This is so because under the New Jersey statute the posting of the security may be required only "at any stage of the proceedings *before* final judgment," so that thereafter the Corporation's right to reimbursement for expenses and counsel fees would be irretrievably lost and appellate review of the order would be meaningless. Moreover, the Corporation being merely a formal party to the action, would normally have no standing to appeal from the final judgment in the main action.

[fol. 47] 15. Petitioner further submits that the question of federal law decided by the District Court as to the binding effect of the New Jersey statute here involved is a question of large importance warranting prompt and authoritative determination. A very considerable volume of corporate litigation is affected thereby, since both New York and Pennsylvania have identical statutes.

16. Jurisdiction of this Court is invoked under section 262 of the Judicial Code (36 Stat. 1162, 28 U. S. C. §377). This Court would have appellate jurisdiction from any final decree in this cause and the jurisdiction of this Court to issue a writ of certiorari or a writ of mandamus in aid of such appellate jurisdiction is hereby invoked.

Wherefore, in the event that this Court determines that the order of United States District Court for the District of New Jersey entered on November 17, 1947, is not appealable, your petitioner respectfully prays:

1. That a writ of mandamus issue out of this Court to the Honorable William F. Smith, Judge of the United States District Court for the District of New Jersey, and to said Court itself; directing that the order entered on November 17, 1947, denying your petitioner's motion for security for expenses, including counsel fees, be vacated and that an order be entered requiring the plaintiff and intervener to give security for the reasonable expenses,

including counsel fees, which may be incurred by your petitioner in this action, and for the reasonable expenses, including counsel fees, which may be incurred by the other parties defendant in connection therewith, for which your petitioner may become subject pursuant to law or to its by-laws or under equitable principles, in such amount as the Court determines to be reasonable; or

2. That a writ of certiorari be issued under the seal of this Court, directed to the United States District Court for [fols. 48-49] the District of New Jersey, sitting in the City of Newark, commanding said Court to certify and send to this Court, on a day to be designated, a full and complete transcript of the record and all proceedings of said Court in this case, to the end that this case may be reviewed and determined by this Court and that the order of the District Court to be reversed; and

3. That the Court grant to your petitioner such other and further relief as may be just and proper.

Dated: December 5, 1947.

Beneficial Industrial Loan Corporation. By Charles Danzig, Charles Danzig, Emerson, Emery & Danzig, Attorneys for Petitioner, 744 Broad Street, Newark, N. J.

Duly sworn to by Charles Danzig, jurat omitted in printing.

Exhibits "A" to "F" inc. to foregoing petition omitted in printing. These exhibits are copies of notice of motion, affidavits, opinion and order appearing at side folios 9 to 39 inc.

[fol. 50] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM 1947

No. 9558

BENEFICIAL INDUSTRIAL LOAN CORPORATION, et al., Petitioners,

v.

HONORABLE WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey, Respondent

RULE TO SHOW CAUSE—Filed December 17, 1948

Present: Biggs, Goodrich and Kalodner, Circuit Judges.

On consideration of the petition of Beneficial Industrial Loan Corporation for a Writ of Mandamus directed to the District Court of the United States for the District of New Jersey and the Honorable William F. Smith, a judge thereof, verified on the 5th day of December, 1947, it is

Ordered that cause be shown by the District Court of the United States for the District of New Jersey and by the Honorable William F. Smith, a judge thereof, before this Court, at the United States Court House, Philadelphia, Pennsylvania, on the 8th day of January, 1948 why a Writ of Mandamus should not be granted, as prayed for in said petition; and it is

Further ordered that leave is granted to Hannah Cohen, Executrix of the Estate of Sol Cohen, deceased and David F. Cohen, parties to the litigation referred to in the petition, to intervene in this proceeding, if they be so advised, and to file an answer to the petition on or before the return day of the rule; and it is

Further ordered that service of a copy of this order and of the petition for a Writ of Mandamus upon the Clerk of the United States District Court for the District of New Jersey at the United States Post Office and Court House, Newark, New Jersey, on or before January 2, 1948 shall be deemed sufficient service.

By the Court, Biggs, United States Circuit Judge.

Dated December 17, 1947.

[fol. 51] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 9567

[Title omitted]

ORDER—Filed January 8, 1948

Before McLaughlin and Kalodner, J. J.

Upon the subjoined consents of the attorneys for the parties hereto, it is on this 8th day of January, 1948,

Ordered that the time for filing answer to the petition for a Writ of Mandamus be extended to January 29, 1948 and that the time within which petitioner may file reply brief be extended to February 18, 1948, and

It is further ordered that the time within which the attorneys for the respondents to the appeal of the defendant, Beneficial Industrial Loan Corporation, from a certain order of the United States District Court for the District of New Jersey, must file their brief be extended to the 29th day of January, 1948, and that the time within which appellant may file a reply brief be extended to February 18, 1948.

McLaughlin, Circuit Court Judge.

We consent to the entry of the foregoing order.

Emerson, Emery & Danzig, Attorneys for Appellant and Attorneys for Petitioner for a Writ of Certiorari or a Writ of Mandamus, 744 Broad Street, Newark 2, New Jersey.

Wall, Haight, Carey & Hartpence, Attorneys for Respondent on Appeal and Attorneys Appearing [fols. 52-53] in Behalf of Plaintiff on Rule to Show Cause why a Writ of Certiorari or a Writ of Mandamus Should Not Issue. 1 Exchange Place, Jersey City 2, New Jersey.

Charles Hershenstein, Attorney for Intervener Respondent on Appeal and Attorney Appearing in Behalf of Intervener on Rule to Show Cause why a Writ of Certiorari or a Writ Mandamus should not issue. 26 Journal Square, Jersey City, New Jersey.

[File endorsement omitted.]

[fol. 40] UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 9558

BENEFICIAL INDUSTRIAL LOAN CORPORATION, Petitioner,

and

HANNAH COHEN, Executrix of the Estate of Sol Cohen, Deceased, and David F. Cohen, Interveners,

v.

HON. WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey, Respondent

No. 9567

HANNAH COHEN, Executrix of the Estate of Sol Cohen, Deceased, Plaintiff; DAVID F. COHEN, Intervener,

v.

BENEFICIAL INDUSTRIAL LOAN CORPORATION, Appellant,

and

O. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, T. FELTER, Jackson R. Collins, C. V. Smith, E. L. Kincaid, Albert G. Morhart, Raymond D. Shepard, Alfred G. Zimmerman, Fred C. Eibell, Richard K. Steinman, and Paul A. Seibold, Individually, Defendants

Appeal from the United States District Court for the District of New Jersey

Argued March 15, 1948

Before Biggs, Chief Judge, O'Connell and Kalodner, Circuit Judges

[fol. 41] OPINION OF THE COURT—Filed September 22, 1948

By BIGGS, Chief Judge:

Hannah Cohen, Executrix of the Estate of Sol Cohen, deceased, is the plaintiff in a stockholders' derivative suit at our No. 9567 brought on August 9, 1943 on behalf of the corporate defendant, Beneficial Industrial Loan Corpora-

tion, a Delaware corporation, against the individual defendants, O. W. Casperson and the others named in the title of this appeal, officers and directors of the corporation. David Cohen intervened on the plaintiff's side. Jurisdiction is based on diversity of citizenship. The complaint is an exceedingly extensive one. It charges the individual defendants with corporate mismanagement and fraud. Article X of the By-Laws of the corporation provides that Beneficial will indemnify a director or officer of the corporation against any claim or demand to which he shall have become subject by reason of his having been an officer or director of the corporation, including reasonable expenses and counsel fees.[1]

The plaintiff and intervener have never held more than 0,01¼% of Beneficial's stock. That corporation, pursuant to the provisions of R. S. 14:3-15, N. J. S. A. 14:3-15, an Act [fol. 42] passed by the New Jersey Legislature which took effect on April 10, 1945 (See N. J. R. S. Cum. Supp. 14:3-17,

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[1] Article X in pertinent part is as follows: "The Corporation shall indemnify and hold harmless each person who shall serve at any time hereafter as a director or officer of the Corporation from and against any and all claims and liabilities to which such person shall have become subject by reason of his having heretofore or hereafter been a director or officer of the Corporation, or by reason of any action alleged to have been heretofore or hereafter taken or omitted by him as such director or officer, and shall reimburse each such person for all legal and other expenses reasonably incurred by him in connection with any such claim or liability; provided, however, that no such person shall be indemnified against, or be reimbursed for any expense incurred in connection with, any claim or liability arising out of his own negligence or wilful misconduct. The rights accruing to any person under the foregoing provisions of this Article shall not exclude any other right to which he may be lawfully entitled, nor shall anything herein contained restrict the right of the Corporation to indemnify or reimburse such person in any proper case even though not specifically herein provided for. The Corporation, its directors, officers, employees and agents, shall be fully protected in taking any action or making any payment under this Article X, or in refusing so to do, in reliance upon the advice of counsel."

N. J. S. A. 14:3-17) moved the court below for an order requiring the plaintiff and intervener to give security in the amount of $125,000. The statutes are set out in the footnote.[2] The court below denied the motion on the ground that R. S. 14:3-15 is remedial in intent and in effect and that therefore the statute's provisions are not binding on a district court of the United States in a suit based on diversity

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[2] N. J. R. S. Cum. Supp. 14:3-15, N. J. S. A. 14:3-15, provides: "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), *the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action.* The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive."

N. J. R. S. Cum. Supp. 14:3-17, N. J. S. A. 14:3-17, provides: "This act shall take effect immediately and shall apply to all such actions, suits or proceedings now pending in which no final judgment has been entered, and to all future actions, suits and proceedings."

For the sake of brevity throughout this text of the opinion in referring to these two statutes we shall omit the references "N. J." and "Cum. Supp."

Emphasis added in this note and throughout the opinion.

as they would be if the Act gave a substantive right. See 7 F. R. D. 352. Beneficial has appealed. As an alternative, in the event the order is found not to be appealable at this stage of the proceeding, it has also petitioned this court at No. 9558 for a writ of certiorari or for a writ of mandamus, to the end that an order be entered by this court directing the court below to give effect to the New Jersey statute and require the plaintiff and the intervener to give security.

As to the Appealability of the Order Complained Of

Preliminarily, we must determine whether the order of the court below is appealable. Our appellate jurisdic-[fol. 43] tion of course is purely statutory. United States v. Horns, 3 Cir., 147 F. 2d 57. Section 128 of the Judicial Code, 28 U. S. C. A. § 225, provides for the appeal of final decisions. But, as was pointed out by Judge Magruder in Rubert Hermanos, Inc. v. People of Puerto Rico, 1 Cir., 118 F. 2d 752, 757, "A 'final decision' is not necessarily the ultimate judgment or decree completely closing up a proceeding. In the course of a proceeding there may be one or more final decisions on particular phases of the litigation, reserving other matters for future determination. See Knox National Farm Loan Ass'n v. Phillips, 300 U. S. 194, 197, 198 . . . ; Trustees v. Greenough, 105 U. S. 527 . . . ; Gay v. Hudson River Electric Power Co., 2 Cir., 184 F. 689; Dant & Russell v. J. D. Halstead Lumber Co., 9 Cir., 103 F. 2d 306. The words 'final decisions,' like the equivalent 'final judgments and decrees' in former acts regulating appellate jurisdiction, have not been understood in a strict and technical sense, but have been given a liberal and reasonable construction. Forgay v. Conrad, 6 How. 201, 203 . . . ; City of Eau Claire v. Payson, 7 Cir., 107 F. 552, 557."

In Cobbledick v. United States, 309 U. S. 323, 328, the opinion by Mr. Justice Frankfurter contains an illuminating discussion of the subject of finality and refers to the "mischief" which may come to pass when an erroneous order, though made early in a proceeding but of final effect in determining a party's right, is considered not appealable. While the Cobbledick opinion deals with a criminal appeal the principle set out therein is equally applicable to civil causes. In United States v. River Rouge Co., 269 U. S. 411, 414, it was said, "While the general rule requires that a judgment of a federal court shall be final and complete be-

fore it may be reviewed on a writ of error or appeal, it is well settled that an adjudication final in its nature as to a matter distinct from the general subject of the litigation and affecting only the parties to the particular controversy, may be reviewed without awaiting the determination of the [fol. 44] general litigation." See also Janssen v. Belding-Corticelli, 3 Cir., 84 F. 2d 577; Stokes v. Williams, 3 Cir., 226 F. 148, cert. den. 241 U. S. 681; Pennsylvania Co. for Insurances on Lives and Granting Annuities v. Philadelphia Co., 3 Cir., 266 F. 1. See also 10 Cyc. Fed. Procedure, 2nd Edition, 1943, p. 231.

The nature of the instant controversy and that of the main action in the case at bar leaves no doubt that Beneficial's application for security is collateral. The corporation seeks to enforce its own right under the statute against the plaintiff and intervener. Its interest in respect to security is adversary to that of the plaintiff and of the intervener. The individual defendants, real parties in interest in the main action, are not involved directly in the controversy as to the giving of security and cannot be affected legally by its determination. In at least two decisions the Supreme Court has come very close to the position asserted by Beneficial. In Trustees v. Greenough, 105 U. S. 527, 531, the Court held that an order awarding expenses and counsel fees to the plaintiff in a representative bondholder's suit was appealable. In the more recent case of Sprague v. Ticonic Bank, 307 U. S. 161, the Court took the position that an issue respecting the allowance of counsel fees and expenses was separate and distinct from the main litigation, outside the original decree of the trial court and the scope of the appellate mandates, and, treating an order denying counsel fees and expenses as appealable, passed upon the merit of the application.

We are not unmindful of the provisions of R. S. 14:3-15 which state that the corporation "at any stage of the proceeding" may make application for security but the court below deemed the statute inapplicable in the instant case at any time. It follows therefore that without the right to sustain an appeal Beneficial could never gain the security to which it is entitled if the statute is applicable for a writ of mandamus could issue from this court only in aid of its appellate jurisdiction. See Section 262 of the Judicial Code, [fol. 45] 28 U. S. C. A. § 377, and United States *ex rel.* Potts v. Rabb, 3 Cir., 147 F. 2d 225, cert. den. 324 U. S. 870. If

the order of the court below is not appealable we would not have the right to issue the writ since insofar as the instant litigation is concerned this court would have no appellate jurisdiction to protect.

We hold the order to be appealable.

The Right Created by the New Jersey Statute and the Conflict of Laws

Beneficial is a Delaware corporation. The law of Delaware is, of course, determinative of the liability of the officers and directors to the corporation and that of the corporation to its officers. Gallup v. Caldwell, 3 Cir., 120 F. 2d 90. On March 31, 1941, Article X of the By-Laws was adopted by the vote of Beneficial's stockholders which, as we have stated, provides for the indemnification by the corporation of directors and officers against any claim or liability to which any of them might become subject by reason of his office. Indemnification is restricted, however, to claims or demands not arising because of the director's or officer's negligence or wilful misconduct. See note 1 *supra*. Article X finds sanction in Section 2 (10) of the Delaware Corporation Law, Delaware Laws 1944, c. 125, Section 1, p. 442. The by-law was couched in the terms of the Delaware statute subsequently enacted.

The law of Delaware is important in the instant case only because it authorizes Beneficial to indemnify the defendants in the instant case if the plaintiff cannot maintain her cause of action. No substantial conflict-of-laws question appears under the circumstances for the obligation of indemnification created by Article X under the Delaware law would be enforceable against Beneficial in any State. The right of the officers and directors of Beneficial to indemnification under the by-law is analogous to a contract right. While a district court of the United States is compelled in diversity cases to follow the rule of law prevailing in the State in which the court sits, Klaxon Co. v. Stentor Co., [fol. 46] 313 U. S. 487, and Jackman v. Equitable Life Assurance Society, 3 Cir., 145 F. 2d 945, we entertain no doubt that a State court of New Jersey would enforce freely and fully any liability arising under the contract. R. S. 14:3-15 simply provides a means whereby the corporation may recoup any losses which it may have sustained by reason of the indemnification of its directors or officers.

The Legislature of New Jersey in enacting the statute intended to prevent losses to both domestic and foreign corporations and to their stockholders by unjustified[3] litigation. We think that it is enough to state now that we can perceive no dichotomy between the laws of New Jersey and Delaware which would permit the plaintiff or the intervener to escape the impact of R. S. 14:3-15, if it is otherwise applicable.

The Public Policy of the State of New Jersey as Embodied in R. S. 14:3-15

It is clear that R. S. 14:3-15 embodies an important public policy of the State of New Jersey and represents an exercise of the police power of that State. The Legislature of New Jersey by enacting the statute intended to prevent losses to both foreign and domestic corporations and their stockholders by "strike" suits. This view was expressed by Governor Walter E. Edge when he approved the Act.[4] He pointed out that the statute's purpose was "to deter the filing of irresponsible suits by persons who either have no legitimate cause of action or who institute such action more for the personal gain of a settlement out of court than in the interest of the corporation or its stockholders. These suits involving the highly complicated transactions of modern corporate business are very costly to defend, regardless of whether or not they may be justifiable. For this reason they have been the subject of great abuse and have been [fol. 47] used to harass corporate officers and directors with baseless litigation . . . It is a minimum protection for corporations and their officers and directors, against 'strike suits' . . ." A statement similar in tenor was attached to Assembly Bill No. 242, which became the Act under consideration, introduced by Assemblyman W. H. Jones in the House of Assembly on March 16, 1945. Governor Thomas E. Dewey of New York made a substantially similar statement with regard to the New York Act, now Section 61-b

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[3] We desire to make it plain that in using this adjective we do not refer to the suit at bar. We are speaking in general terms of the intent of the New Jersey Legislature.

[4] See "Governor's Press Releases of 1945," p. 317, retained in The State House at Trenton, or, Newark Evening News, Suburban Ed., April 12, 1945, p. 20, column 1.

of the General Corporation Law of New York. Governor Dewey said, ". . . many suits that were well based have been brought, not in the interest of the corporation or of its stockholders, but in order to obtain money for particular individuals who had no interest in the corporation or in its stockholders. Secret settlements—really payoffs for silence—have been the subjects of common suspicion." [5] The New York statute is almost identical with that of New Jersey. See as cited in note 15 *infra*.

The Application of R. S. 14:3-15 in the Case at Bar, So-Called "Retroactive" Provisions Aside

Without regard to the question whether the New Jersey statute creates a substantive right or is merely remedial we conclude that the statute is applicable in the case at bar, the so-called "retroactive" effect of R. S. 14:3-17 aside,[6] because it states an important public policy of the State of New Jersey. The way to our conclusion was pointed out by the Supreme Court in Sioux County v. National Surety Co., 276 U. S. 238, in 1928. The principle of the Sioux County case was strengthened by Erie R. Co. v. Tompkins, 304 U. S. 64, and by Griffin v. McCoach, 313 U. S. 498, as exemplified by Guaranty Trust Company v. York, 326 U. S. 99, culminating perhaps [7] in Angel v. Bullington, 330 U. S. 183. [fol. 48] In the Sioux County case the Supreme Court held that a Nebraska statute which provided that in actions on guarantees and specified insurance contracts an attorney's fee should be "taxed as part of the costs," was to be given effect in a federal court in a suit against a guarantor. The guarantee had been entered into after the Nebraska Act (Neb. Comp. Stat., 1922, § 7811) had been passed. The Supreme Court of Nebraska in Nye-Schneider-Fowler Co. v. Bridges, Hoye & Co., 98 Neb. 863, 155 N. W. 235, a suit on an insurance contract entered into apparently before the statute's enactment, designated the Nebraska Act as "remedial" or as a "costs" statute thereby avoiding the impact of the Contract Clause. At p. 867 (155 N. W. at pp.

[5] See New York Times, March 9, 1945.

[6] The alleged retroactive effect of the statute is dealt with at a later point in this opinion. See R. S. § 14:3-17, N. J. S. A. 14:3-17.

[7] We use this word because we think the end is not yet.

236-7) the Supreme Court of Nebraska stated: "If the question that we are considering was now presented for the first time, we would hesitate to say that this statute does not create and add to the contract a legal liability which would not exist under the contract prior to the enactment of this statute. The fact that the attorney's fee is to be taxed as costs in the case is not of itself decisive of the question." In the Sioux County case Mr. Justice Stone, after quoting the foregoing statement of the Nebraska Supreme Court, went on to say: "But the question before the Nebraska court in the cases cited was not that with which we are now concerned. Whether this liability for an attorney's fee, assumed by entering into an insurance contract after the enactment of the statute providing for the liability, may be enforced in the federal courts does not depend on any nice distinctions which may be taken between the right created and the remedy given. Disregarding mere matters of form it is clear that *it is the policy of the state* to allow plaintiffs to recover an attorney's fee in certain cases, and it has made that policy effective by making the allowance of the fee mandatory on its courts in those cases. It would be at least anomalous if this policy could be thwarted and the right so plainly given destroyed by removal of the cause to the federal courts."

[fol. 49] In Erie R. Co. v. Tompkins, 304 U. S. 64, the Supreme Court laid down the fundamental principle, overruling the doctrine of Swift v. Tyson, 16 Pet. 1, and depreciating the rule of law which sanctioned different results in litigation if tried in a federal court as distinguished from a State tribunal; and concluded that, except where the Federal Constitution or Acts of Congress required otherwise, the law to be applied in any case is the law of the State. Mr. Justice Brandeis, *Id.* at p. 71, referred to the Rules of Decision Act, 28 U. S. C. A. § 725, as determining the question whether the Pennsylvania rule of law which imposed liability on the owner of premises only for wilful and wanton injury to a trespasser was applicable. There would be little profit in discussing in this opinion whether the Pennsylvania rule was one of substance or went only to the remedy but using the ancient tests we may conclude that the rule of law was probably "substantive" in its nature as that quoted term has been usually employed. We think it must be gathered from Erie R. Co. v. Tompkins that the Supreme Court required district courts of the United States to stand bound

upon the public policy of the individual States as declared by the decisions of the State courts. Erie R. Co. v. Tompkins declared a major doctrine of constitutional law.

In Griffin v. McCoach, 313 U. S. 498, after citing Klaxon Co. v. Stentor Mfg. Co., 313 U. S. 487, for the proposition that the rules of conflict of laws governing a federal court in diversity cases are those of the State in which the federal court sits, the Supreme Court held that the public policy of Texas as to the existence or non-existence of an insurable interest under a life insurance contract must be determined by the Texas decisions, the courts of the United States being compelled to effect the law of Texas in this respect. This decision stems clearly from Erie R. Co. v. Tompkins.

In Guaranty Trust Company v. York, 326 U. S. 99, the Supreme Court indicated that that doctrine of constitutional law, expressed in the Erie R. Co. case and in Griffin [fol. 50] v. McCoach, implicit in the Sioux County decision, required federal courts sitting in diversity cases to apply any statute of a State which might effect a substantial difference in the respective rights or statuses of the parties. In short, the Court ruled that the litigant who comes into a federal court should have the substantial rights which he would have in a State tribunal. There was qualification to this principle but it is not pertinent here.[8] It should be borne in mind that in the Guaranty Trust Company case the question before the Supreme Court was whether a statute of limitations of New York should operate to bar the plaintiff's suit. We venture to suggest that prior to this decision few members of the bar had doubted that a statute of limitations was procedural and not substantive. But the Supreme Court required the New York statute to be applied by a district court sitting in equity despite the fact that the jurisdiction of district courts of the United States so sitting traditionally had corresponded to that of the English Court of Chancery: Michoud v. Girod, 4 How. 503, 561. Mr. Justice Frankfurter said, *Id.* at p. 108: ". . . since a federal court adjudicating a State-created right solely because of the diversity of citizenship of the parties is for that purpose, in effect, only another court of the State, it cannot afford recovery if the right to recover is made un-

[8] See Guaranty Trust Co. v. York, 326 U. S. at p. 105, quoted by the court below in its opinion, 7 F. R. D. at p. 355.

available by the State nor can it substantially affect the enforcement of the right as given by the State. And so the question is not whether a statute of limitations is deemed a matter of 'procedure' in some sense. The question is whether such a statute concerns merely the manner and the means by which a right to recover, as recognized by the State, is enforced, or whether such statutory limitation is a matter of substance in the aspect that alone is relevant to our problem, namely, does it significantly affect the result of a litigation for a federal court to disregard a law of a State that would be controlling in an action upon the [fol. 51] same claim by the same parties in a State court? It is therefore immaterial whether statutes of limitation are characterized either as 'substantive' or 'procedural' in State court opinions in any use of those terms unrelated to the specific issue before us. *Erie R. Co. v. Tompkins* was not an endeavor to formulate scientific legal terminology. It expressed a policy that touches vitally the proper distribution of judicial power between State and federal courts. In essence, *the intent of that decision was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court.*" Any statute of limitations declares a public policy of a State to set a period after which suits may not be brought.

Angel v. Bullington, 330 U. S. 183, again makes plain the insistence of the Supreme Court that a federal court sitting in a diversity suit must enforce State law and State policy. In the Angel case a statute of North Carolina (30, Public Laws, 1933, Michie's Code, § 2593) precluded recovery of a deficiency judgment in North Carolina for unpaid notes secured by a mortgage. The Supreme Court of North Carolina, 220 N. C. 18, 20, 16 S. E. 2d 411, 412, had held that "The statute operates upon the adjective law of the state, which pertains to the practice and procedure, or legal machinery by which the substantive law is made effective, and not upon the substantive law itself. It is a limitation of the jurisdiction of the courts of this state." Bullington did not appeal the decision to the Supreme Court of the United States but brought a new action for a deficiency judgment in the District Court of the United States for the

Western District of North Carolina. He recovered judgment, the decision being affirmed, 150 F. 2d 679. The Supreme Court of the United States, reversing, stated that it was necessary for the federal courts in diversity cases to [fol. 52] give effect to the public policy of the States. Mr. Justice Frankfurter said at p. 191, "It is suggested that the North Carolina Supreme Court construed the North Carolina statute to close only the North Carolina State courts but not the federal court sitting in North Carolina. In the first place, the North Carolina Supreme Court said no such thing. It construed the statute expressive of State policy and spoke only of the jurisdiction of the State courts because it was concerned only with the State courts. Secondly, it is most incongruous to attribute to the legislature and judiciary of North Carolina the imposition of a restriction against all its citizens from suing for a deficiency judgment while impliedly authorizing citizens of other States to secure such deficiency judgments against North Carolinians. Thirdly, a North Carolina statute, upheld by the highest court of North Carolina, is of course expressive of North Carolina policy. *The essence of diversity jurisdiction is that a federal court enforces State law and State policy.* If North Carolina has authoritatively announced that deficiency judgments cannot be secured within its borders, it contradicts the presuppositions of diversity jurisdiction for a federal court in that State to give such a deficiency judgment. North Carolina would hardly allow defeat of a State-wide policy through occasional suits in a federal court. What is more important, diversity jurisdiction must follow State law and policy. A federal court in North Carolina, when invoked on grounds of diversity of citizenship, cannot give that which North Carolina has withheld. Availability of diversity jurisdiction which was put into the Constitution so as to prevent discrimination against outsiders is not to effect discrimination against the great body of local citizens."

Now it must be conceded in the case at bar that the right to security given to Beneficial by R. S. 14:3-15 is not a part of and is legally unconnected with the causes of action asserted by the plaintiff against the individual defendants for the benefit of the corporate defendant. It is as if a [fol. 53] little cause of action had been engrafted on the body of the main suit for the benefit of the corporation. There can be no doubt, however, that the New Jersey statute im-

poses a limitation on the right of the plaintiff to maintain her suit. R. S. 14:3-15 is a kind of legal hybrid, functioning both by way of limitation and creation. It is in some respects an extension of the New Jersey Chancery Act, R. S. 2:29-131, N. J. S. A. 2:29-131, which gives a right to the Court of Chancery of New Jersey to award counsel fees and costs as between party and party, but as was pointed out by Chief Judge Lehman in Shielcrawt v. Moffett, 294 N. Y. 180, 190, 61 N. E. 2d 435, 440, in construing Section 61-b of the General Corporation Law of New York,[9] upon which R. S. 14:3-15 was patterned, " . . . the statute [61-b] creates a remedy for a wrong for which previously there was no remedy, and it interferes with the antecedent right of small stockholders to maintain derivative actions in behalf of the corporation and gives to corporations rights which they had not previously enjoyed."[10]

But the exact nature of the right given to a corporation need not be determined on this aspect of the case for it is clear that it is a substantial one[11] and that it embodies the public policy of New Jersey. The question for our determination therefore is: Putting the so-called "retroactive" application of R. S. 14:3-15 aside, can the plaintiff by coming into the District Court of the United States for the District of New Jersey avoid a limitation upon her action which she would be subjected to had she filed suit in the Court of Chancery of New Jersey? In short, can she escape the limitation of the New Jersey statute by entering the

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[9] See Sections 61-b, 64 and 67 of the General Corporation Law of the State of New York, McKinney's Consolidated Laws of New York Ann., Book 22, 1948 Supp.

[10] We shall deal at somewhat greater length with the nature of the right given to Beneficial at that point of this opinion which discusses the so-called "retroactive" effect of the statute under R. S. 14:3-17, N. J. S. A. 14:3-17.

[11] Beneficial alleges that the costs and counsel fees for which it will be liable will amount to $125,000. Though this estimate may well be taken with salt we entertain no doubt that the amount involved will be large. It will be the duty of the court below on remand to determine the proper amount of the security to be given.

[fol. 54] federal court house rather than that of the State? We think the answer must be in the negative.[12]

If this be a limitation on the jurisdiction of the District Court of the United States for the District of New Jersey it is none the worse for so being. In Angel v. Bullington the Supreme Court by requiring the District Court of the United States for the Western District of North Carolina to give full effect to the North Carolina statute imposed a limitation upon the jurisdiction of that court and expressly declared, 330 U. S. at p. 192, "Cases like *Lupton's Sons Co.* v. *Automobile Club*, 225 U. S. 489, are obsolete insofar as they are based on a view of diversity jurisdiction which came to an end with *Erie Railroad* v. *Tompkins*, 304 U. S. 64. That decision drastically limited the power of federal district courts to entertain suits in diversity cases that could not be brought in the respective State courts or were barred by defenses controlling in the State courts."

In view of what has been said we deem it unnecessary to comment at length on Pusey & Jones Co. v. Hanssen, 261 U. S. 491, 497, relied on in the opinion of the court below. In that case, as is pointed out in note 3 to the opinion in Guaranty Trust Co. v. York, cited to the text at 326 U. S. p. 106, the Supreme Court had to decide whether a Delaware statute (Revised Code of Delaware, 1915, Section 3883) had created a new right appropriate for enforcement in accordance with traditional equity practice or whether the Act had given the Chancery Court of Delaware a new kind of remedy. The Supreme Court held that the Delaware statute was remedial and did not create a new interest in a simple contract creditor as distinguished from a secured creditor, applying for a receiver for an insolvent Delaware corporation. With words as cold and sharp as the point of a scalpel the late Chancellor Wolcott [fol. 55] cut the ligatures which bound the Hanssen case to

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[12] We are aware that our decision is contrary in substance to that of Aspinook Corporation v. Bright, 2 Cir. 165 F. 2d 294, and directly contrary to decisions such as Boyd v. Bell, D. C. S. D. N. Y., 64 F. Supp. 22, and the other authorities cited to the point in 165 F. 2d at p. 295. Cf. Donovan v. Queensboro Corporation, D. C. E. D. N. Y., 75 F. Supp. 131. While these decisions are entitled to great weight we cannot follow them.

the law of Delaware. See Mackenzie Oil Co. v. Omar Oil & Gas Co., 14 Del. Ch. 36, 45, 120 A. 852, 856. But despite the note referred to in Guaranty Trust Co. v. York we cannot say that the decision in the Hanssen case retains its full potency in the courts of the United States. If, as we have decided, we may not concern ourselves in the case at bar with the ancient diversities between adjective and substantive law, the Hanssen case must be by-passed. If it is to be overruled, it must be by the Supreme Court. The Hanssen case in view of the authorities previously cited may by 1948 have become a signpost on a one-way street leading ultimately to that legal border where substance and procedure will become in law, as in fact, one.

We can perceive no reason why the provisions of R. S. 14:3-15 should not be as fully operative in respect to a suit against a foreign corporation, such as Beneficial, as in a suit against a New Jersey corporation. It is the express policy of R.S. 14:3-15 to protect foreign as well as domestic corporations. The fact that Delaware has no statute corresponding to those of New Jersey and New York is immaterial.[13] The New Jersey statute finds its vitality in the District Court of New Jersey by reason of the Rules of Decision Act and the decisions of the Supreme Court in interpreting that Act from the Sioux County case to Angel v. Bullington.

The point set up in the able opinion of the court below, 7 F. R. D. at p. 356, that R. S. §§ 823, 824, 28 U. S. C. A. §§ 571, 572, prohibits the allowance of the expenses contemplated by the New Jersey statute (for which security is to be required) is fully answered by the Sioux County case, 276 U. S. at p. 244. In the cited case it was held that counsel fees under the Nebraska statute though allowed [fol. 56] and "taxed as part of the costs" were not costs in the ordinary sense and not taxable as costs under R. S. §§ 823, 824 in the federal court.

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[13] It should be pointed out again, as stated at an earlier point in this opinion, that Article X finds full support in Section 2(10) of the Delaware Corporation Law. If the plaintiff's suit is unsuccessful, Beneficial will be liable for the individual defendants' counsel fees and costs. It is clear that the public policy of New Jersey as embodied in R.S. 14:3-15 is in nowise inconsistent with that of Delaware as disclosed in Section 2(10) of the Delaware Corporation Law.

As to Constitutionality Generally, and as to the So-Called Retroactive Application of the New Jersey Statute

It cannot be seriously contended that R. S. 14:3-15 would be unconstitutional as applied to any suit commenced after the date of its approval. The substantial question raised on this appeal on this aspect of the case is, we think, answered fully and clearly by the decision of Chief Judge Loughran in Lapchak v. Baker,* — N. Y. —, 80 N. E. 2d 751, dealing with the constitutionality of Section 61-b of the General Corporation Law of New York. The contrary view is succinctly presented by Zlinkoff in his virile article entitled "The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Law", 54 Yale L. J. pp. 352-392. The learned writer, relying on the Due Process Clause, asserts *Id.* at pp. 374 *et seq.* that the operation of Section 61-b ". . . will deprive a great majority of stockholders of the only available judicial remedy for the protection of their rights", by requiring security from them in an amount which they cannot produce. But R. S. 14:3-15 requires "security for the *reasonable* expenses, including counsel fees, which may be incurred" by the corporation and by other parties defendant. The statute also provides that the amount of the security required by the court may be increased or decreased from time to time as it may become "inadequate" or "excessive". It is clear, we think, that the last two adjectives quoted must be read in connection with the adjective "reasonable" italicized above. In other words the test is the amount of the expenses reasonably to be anticipated rather than the extent or capacity of the plaintiff's pocketbook. But the amount of the security to be required by the trial court is [fol. 57] not presently before us. No amount of security was set by the court below for the reason that it was of the opinion that the statute was inapplicable. Any question relating to the amount of the security is still *in nubibus* and we cannot pass upon it in the absence of an order based on appropriate findings by the court below. An analogy is presented by the extent of the review in the Lapchak case. See the last sentence of the seventh paragraph of the opinion of the Court of Appeals of New York.

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* Decided July 16, 1948.

In conclusion upon this point we point out that it is not the duty of a court to pass upon the wisdom of a public policy effected by a legislature. Much of the plaintiff's and intervener's argument as well as that of the Zlinkoff article is addressed to the wisdom of statutes such as that *sub judice*. It is pointed out by the latter that Section 61-b does not meet the worst feature of the groundless "strike" suit in that the statute does not prohibit secret settlements. This is true also of R. S. 14:3-15. But the Legislatures of the States are in a very real sense laboratories for legislation and early experiments are rarely perfect. We may inquire, as did the Supreme Court of the United States by Mr. Justice Roberts in Nebbia v. New York, 291 U. S. 502, 515, into "the occasion for the legislation and its history." We did this under the previous heading of this opinion. But we think that it cannot be asserted fairly that the provisions of R. S. 14:3-15 do not represent a reasonable effort by New Jersey to eradicate an evil deemed by its Legislature to be widespread. We may not hold the statute unconstitutional on the showing made by the plaintiff and intervener.

As to the so-called retroactive application of R. S. 14:3-15, R. S. 14:3-17 provides that the effective date of R. S. 14:3-15 should be immediately upon its approval, viz., on April 10, 1945, "and [that R. S. 14:3-15] shall apply to all such actions, suits or proceedings now pending in which no final judgment has been entered, and to all future actions, suits or proceedings." The suit at bar was filed on [fol. 58] August 9, 1943 and Beneficial's application for security under the Act was not filed until August 5, 1946. We agree with those portions of the opinion of the learned District Judge, 7 F. R. D. 355-7, which hold that the right given by R. S. 14:3-15 is largely remedial, though, as we have stated, the right is actually a hybrid. The view that a statute of the character of R. S. 14:3-15 is somewhat remedial in nature was expressed by the Court of Appeals of New York by Chief Judge Lehman in Shielcrawt v. Moffett, *supra*, though that Court did not pass upon the question of whether Section 61-b of the General Corporation Law of New York applied retroactively would be constitutional.[14] The plaintiff and the intervener contend that

[14] The New York Legislature omitted the formula embodied in R. S. 14:3-17 and quoted in the paragraph of the

the application of the New Jersey statute to the suit at bar would abridge the equity jurisdiction of the Court of Chancery in violation of Article VI, Section 1, of the New Jersey Constitution, citing Ex parte Hague, 104 N. J. Eq. 31, 144 A. 546, aff'd 104 N. J. Eq. 369, 145 A. 618, and other authorities including Eastwood Nealley Corp. v. International etc. Dist. 47, 124 N. J. Eq. 274, 1 A. 2d 477.

We cannot agree. The court below, quite properly, as we think, treated R. S. 14:3-15 as an extension in principle of the provisions of the New Jersey Chancery Act, in pertinent part embodied in R. S. 2:29-131, by which the Court of Chancery of New Jersey is empowered to award counsel fees and costs as between party and party. If we are correct in this conclusion it is clear that no provision of the Constitution of New Jersey will be violated by applying the provisions of the statute to the instant suit. The Courts of New Jersey, including the Court of Errors and Appeals, have held that statutes creating a right to counsel fees "as part of the taxable costs" may be applied to pending actions. See Igoe Bros. v. National Surety Co., 112 N. J. L. [fol. 59] 243, 169 A. 841; Robinson v. Jackson (Ct. Com. Pleas), 14 N. J. Misc. 866, 187 A. 918; and Murphy v. Brown & Co. (Sup. Ct.), 91 N. J. L. 412, 103 A. 28. True, these decisions are based upon the proposition that such statutes are remedial only but nonetheless the decisions cited are clear rulings to the effect that no provision of the New Jersey Constitution is violated. Interpretations of the New Jersey Constitution by the courts of New Jersey are binding on us on this point of the instant case. By analogy, we are forced to the conclusion that the courts of New Jersey would also hold that the application of the statute *sub judice*, even to suits pending at the time of its approval, would violate no provision of the Constitution of New Jersey.

In so stating we are aware that a right beyond that given by the pertinent section of the Chancery Act, R. S. 2:29-131, is awarded to corporations by R. S. 14:3-15. The pertinent provisions of the Chancery Act state that the Chancellor may make an allowance by way of counsel fee

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opinion to which this note is cited. The Court of Appeals of New York held that since the New York statute omitted that formula the Legislature did not intend that Section 61-b should be applied to a stockholder's derivative suit pending at the time of its approval.

"to the party obtaining the order or decree". Assuming that a decree in favor of the plaintiff against the individual defendants awarding a sum of money to Beneficial might be deemed to be a decree "obtained" by it, (and even to state such an assumption is in reality to refute it) Beneficial under R. S. 2:29-131 could obtain only its own counsel fees and expenses and could secure no indemnification whatsoever for sums expended by it to pay the counsel fees and expenses of the individual defendants. But the remedy or right conferred on corporations by R. S. 14:3-15 clearly proceeds along the same general lines of indemnification as those laid down by R. S. 2:29-131 of the Chancery Act. We are of the opinion that no clear-cut and effective distinction in principle between R. S. 14:3-15 and R. S. 2:29-131 is possible.[15]

[fol. 60] The plaintiff and intervener also contend that R. S. 14:3-15 violates the Contract Clause of the Federal Constitution. But the right of a stockholder to prosecute a derivative action is not a contractual right. We know of no Delaware decision which suggests even remotely that a stockholder's derivative suit is based upon breach of contract. The right of a stockholder of a Delaware corporation to maintain a derivative suit on behalf of the corporation is based upon a breach of fiduciary duty by the directors or officers of the corporation. The officers and directors of a Delaware corporation are trustees for its stockholders under Delaware law. Lofland v. Cahall, 13 Del. Ch. 384; 118 A. 1; Bodell v. General Gas & Electric Corp., 15 Del. Ch. 119, 132 A. 442. Cf. Irving Trust Co. v. Deutsch, 73

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[15] Compare Section 61-a of the General Corporation Law of New York with Section 61-b, and Section 61-b with R. S. 2:29-131 and R. S. 14:3-15. Section 61-a provides that in any action, suit or proceeding against one or more officers or directors of a corporation "brought by the corporation, or brought in its behalf . . . by one or more stockholders . . . the reasonable expenses, including attorneys fees, of any party plaintiff or party defendant incurred in connection with the successful prosecution or defense of such action, suit or proceeding shall be assessed upon the corporation."

The two sections of the General Corporation Law of New York and the two sections of the New Jersey law operate in a similar field.

F. 2d 121. The cases cited by the plaintiff and intervener as sustaining their position are inapposite.

We conclude also that the application of R. S. 14:3-15 to the suit at bar will not fall within the prohibition of the Fourteenth Amendment of the Constitution of the United States. The remedy selected by the New Jersey Legislature was reasonable in view of the evil which the legislature has sought to cure. The plaintiff is not deprived of her cause of action by the New Jersey statute and she may assert her remedy subject to a reasonable condition. The right to bring a stockholder's derivative suit is not a property right and as this court held in Overfield v. Pennroad Corporation, 146 F. 2d 889, 894, quoting 4 Pomeroy § 1095, the individual stockholder is permitted to sue "simply in order to set in motion the judicial machinery of the court." As was said by the Supreme Court in Klein v. Board of Supervisors, 282 U. S. 19, 24, ". . . it leads nowhere to call a corporation a fiction. . . . The corporation is a person and its ownership is a nonconductor that [Fol. 61] makes it impossible to attribute an interest in its property to its members." A stockholder's suit is a suit by the corporation conducted by the stockholder as its representative. Fletcher Cyclopedia Corporations (Perm. Ed. 1943, Rev. Vol. (§ 5939)). In Jones v. Union Guano Co., 264 U. S. 171, 181, the Supreme Court said, "The Fourteenth Amendment does not prevent a State from prescribing a reasonable and appropriate condition precedent to the bringing of a suit of a specified kind or class so long as the basis of distinction is real, and the condition imposed has reasonable relation to a legitimate object." While it is true that in the cited case the State statute (Section 7, c. 143, Laws of North Carolina of 1917) which prohibited a suit being brought for alleged defective fertilizer until after chemical analysis showing its ingredients had been made, was enacted prior to the time that the plaintiff commenced his suit, the principle stated is nonetheless applicable here. Although R. S. 14:3-15 and R. S. 14:3-17 did create a limitation on the right of the plaintiff to *maintain* the suit at bar it is a reasonable limitation when one considers the nature of the evil attempted to be cured. Moreover, the limitation imposed by the statutes does not run to the plaintiff's right to maintain her suit which remains legally unimpaired. On this aspect of the case as we have stated the New Jersey statutes are largely procedural and

remedial, rather than substantive. Last, the mere fact that a statute is retroactive does not render it unconstitutional. Blount v. Windley, 95 U. S. 173, 180; Western Union Telegraph Co. v. L. & N. R. R. Co., 258 U. S. 13; cf. United States *ex rel.* Rodriguez v. Weekly Publications, Inc., 2 Cir. 144 F. 2d 186.

We conclude that the application of R. S. 14:3-15 to the instant suit is constitutional.

As to the Application of the Act to the Suit at Bar

We should point out, though the question is not immediately before us, that the wording of R. S. 14:3-15 leaves no discretion in the court below to require security [fol. 62] of the plaintiff or the intervener. The only discretion conferred on the court by R. S. 14:3-15 is as to the *amount* of the security and of the subsequent reimbursement. The Act provides that the corporation "shall be entitled . . . to require the complainant . . . to give security . . ., to which the corporation shall have recourse in such *amount* as the court . . . shall determine . . ." This interpretation is in accord with that given to the New York statute, Section 61-b, which as has been observed is almost identical in terms with the New Jersey Act. See Isensee v. Long Island Motion Picture Co., 184 Misc. 625, 54 N. Y. S. 2d 556, and Shielcrawt v. Moffett, 294 N. Y. at p. 187, 61 N. E. 2d at 438.[16] The courts of New Jersey will find the interpretation of Section 61-b by the New York courts to be persuasive in construing R. S. 14:3-15. See in re Cook's Estate, 118 N. J. Eq. 288, 291, 179 A. 259, 260.[17]

[16] Judge Lehman said, ". . . if the defendants succeed in their defense, the corporation . . . will be subject to liability for expenses of substantial amount incurred not only by itself but also by the individual defendants; and the corporation will have no recourse to the defeated plaintiffs for indemnity or reimbursement unless it is entitled to require the plaintiffs to give security as provided in section 61-b."

[17] The Court of Errors and Appeals said, ". . . when it is clear . . . that the legislation is but the enactment in this state of the law of another state or country, the interpretation as given in the place from which it is taken will be presumed to be that intended by the Legislature of our own state in so adopting it."

The remaining points raised by the parties do not require discussion.

Our decision makes it unnecessary for this court to pass upon Beneficial's application for mandamus or certiorari. Consequently an order will be entered at No. 9558 dismissing the petition. An order will be entered at No. 9567 reversing the order of the court below and remanding the cause with the direction to proceed in accordance with this opinion.

A true Copy:
Teste:

——— ———, Clerk of the United States Court of Appeals for the Third Circuit.

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[fol. 63] UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 9567.

HANNAH COHEN, Executrix of the Estate of SOL COHEN, Deceased, Plaintiff,

DAVID F. COHEN, Intervener,

v.

BENEFICIAL INDUSTRIAL LOAN CORPORATION, Appellant,

and

O. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, T. Felter, Jackson R. Collins, C. V. Smith, E. L. Kincaid, Albert G. Morhart, Raymond D. Shepard, Alfred G. Zimmerman, Fred C. Eibell, Richard K. Steinman, and Paul A. Seibold, Individually, Defendants

DECREE

Present: Biggs, Chief Judge, O'Connell and Kalodner, Circuit Judges.

And Now, to wit, this 22nd day of September, 1948,

It Is Ordered that the order of the court below denying security to Beneficial Industrial Loan Corporation, pursuant to the provisions of N.J.R.S. Cum. Supp. 14:3-15 and N.J.R.S. Cum. Supp. 14:3-17, be and the same hereby is

reversed and the cause is remanded with the direction to proceed in accordance with the opinion of this court, with costs.

For the Court, Biggs, Chief Judge.

Endorsements: Decree Reversing Order of District Court, etc. Received & Filed Sept. 22, 1948.

Ida O. Creskoff, Clerk.

[fol. 64] I, Ida O. Creskoff, Clerk of the United States Courts of Appeals for the Third Circuit, Do Hereby Certify the foregoing to be a true and faithful copy of the original Appendix to Brief for Beneficial Industrial Loan Corporation, and proceedings in this Court in the cases of Beneficial Industrial Loan Corporation, et al. vs. Hon. William F. Smith, a Judge of the United States District Court for the District of New Jersey, No. 9558; and Hannah Cohen, et al. vs. Beneficial Industrial Loan Corp., et al., No. 9567, on file, and now remaining among the records of the said Court, in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this 11th day of October in the year of our Lord one thousand nine hundred and forty-eight, and of the Independence of the United States the one hundred and seventy-third.

Ida O. Creskoff, Clerk of the U. S. Court of Appeals, Third Circuit. (Seal.)

[fol. 77] In United States Court of Appeals for the Third Circuit

No. 9558

Beneficial Industrial Loan Corporation, Petitioner,
and
Hannah Cohen, Executrix of the Estate of Sol Cohen, Deceased, and David F. Cohen, Interveners,

v.

Hon. William F. Smith, a Judge of the United States District Court for the District of New Jersey, Respondent

Decree—Filed September 22, 1948

Present: Biggs, Chief Judge; O'Connell and Kalodner, Circuit Judges.

And now, to wit, this 22nd day of September, 1948,

It is ordered that the petition filed herein by Beneficial Industrial Loan Corporation for a writ of certiorari or mandamus be and the same hereby is dismissed.

For the Court.

Biggs, Chief Judge.

[File endorsement omitted.]

[fol. 78] I, Ida O. Creskoff, Clerk of the United States Courts of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original Petition of Beneficial Industrial Loan Corporation for a Writ of Certiorari or for a Writ of Mandamus and Motion for Rule to Show Cause, and proceedings in this court, in the case of Beneficial Industrial Loan Corporation, et al. vs. Honorable William F. Smith, a Judge of the United States District Court for the District of New Jersey, No. 9558, on file, and now remaining among the records of the said Court, in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this 30th day of December in the year of our Lord one thousand nine hundred and forty-eight, and of the Independence of the United States the one hundred and seventy-third.

Ida O. Creskoff, Clerk of the U. S. Court of Appeals, Third Circuit. (Seal.)

SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1948

No. 512

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

Upon consideration of the application of counsel for petitioner(s),

It is ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including January 15, 1949.

Harold H. Burton, Associate Justice of the Supreme Court of the United States.

Dated this 19th day of December, 1948.

[fol. 79] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1948

No. 442

ORDER ALLOWING CERTIORARI—Filed February 28, 1949

The petition herein for a writ of certiorari to the United States Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 80] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1948

No. 512

ORDER ALLOWING CERTIORARI—Filed February 28, 1949

The petition herein for a writ of certiorari to the United States Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

LIBRARY
SUPREME COURT U S

Supreme Court of the United States

OCTOBER TERM, 1948.

No.

HANNAH COHEN, Executrix of the Estate of Sol Cohen, Deceased, and DAVID F. COHEN, Intervenor,

Petitioners,

—against—

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Respondent,

—and—

O. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAUL A. SEIBOLD, individually,

Defendants.

PETITION FOR CERTIORARI.

EDWARD J. O'MARA,
CHARLES HERSHENSTEIN,
SAMUEL DRESKIN,
Attorneys for the Petitioners.

PHILIP B. KURLAND,
Of Counsel.

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> vant to our problem, namely does it significantly affect the result of a litigation for a federal court to disregard a law of a State that would be controlling in an action upon the same claim by the same parties in a State court?"

Clearly, the posting of a bond in advance to secure the payment of costs, the liability for which may or may not eventuate, "concerns merely the means by which a right to recover, as recognized by the State, is enforced." And the Third Circuit was in error in ruling that the federal courts are bound by the New Jersey statute requiring an advance bond to secure a potential judgment.

Moreover, chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17), like its model, Section 61-b of the New York General Corporation Law, was said to be addressed to certain alleged abuses inherent in derivative stockholders' actions. Assuming *arguendo* that the statute was so directed, for another reason it is clear that it cannot be applied in the federal courts. Congress and this Court have already met the abuses they believe significant by Rule 23[9] of the Federal Rules of Civil Procedure. Thereby, it has been indicated that for the purposes of the Rules of Decisions Act, 28 U. S. C. § 1652 (previously 28 U. S. C. § 725), and *Erie R. R.* v. *Tompkins*, 304 U. S. 64 (1938), federal law, not state law, shall be governing. Rule 23 is an "Act of Congress" within the meaning of the Rules of Decisions Act. See *Sibbach* v. *Wilson & Co.*, 312 U. S. 1, 15-16 (1940). In short, the federal government has occupied the field and in accordance with the very terms of the Rules of Decisions Act state law may not

[9] Rule 23 insures adequate representation, safeguards against lack of good faith by requiring a verified complaint, outlaws the "strike suit" by requiring that the plaintiff be a shareholder at the time of the transaction of which he complains, prevents secret and unfair settlements by forbidding dismissal without the approval of the court and dismissal or compromise without notice to the stockholders.

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govern.[10] Moreover, to use a term drawn from the field of conflict of laws, the federal government has characterized its rule as procedural and therefore conflicting or similar statutes or rules must be similarly characterized for the purposes of the doctrine of *Erie R. R.* v. *Tompkins*.

III.

N. J. R. S. CUM. SUPP. 14:3-15 AND 14:3-17 VIOLATE THE FEDERAL CONSTITUTION.[11]

The constitutional issues presented in this section of the brief and in Section IV can be reached only if the Court rejects the contentions heretofore made that the New Jersey legislation is not applicable in the federal courts. Apart from constitutional objections to the retroactive effect of Chapter 131, the provisions of that chapter, here at issue, violate the federal Constitution in the following manner:

A. Equal Protection of the Laws.

N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17 are discriminatory upon their face. They subject to liability for expenses and counsel fees, as well as for security, only stockholders holding shares "having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares" unless the market value of such shares is in excess of $50,000. No basis in law or in fact is available to support this classification. The only classification is upon the basis

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[10] "The laws of the several states, except where the Constitution or treaties of the United States or *Acts of Congress otherwise require or provide*, shall be regarded as rules of decisions in civil actions in the courts of the United States, in cases where they apply." (Emphasis added.)

[11] We do not at this time present argument with respect to the constitutionality of N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17 under either the New Jersey Constitution of 1844, which was in effect at the time of the passage of these provisions, or under the New Jersey Constitution of 1947 which subsequently became effective. But we reserve our right to do so, in the event that certiorari is granted.

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of wealth, and such unequal justice is exactly the type of discrimination outlawed by the Fourteenth Amendment. As the Court stated in *Gulf, C. & S. R. Co. v. Ellis*, 165 U. S. 150, 155 (1897),

> "The State may not say all white men shall be subjected to the payment of the attorney's fees of parties successfully suing them and all black men not. It may not say that all men beyond a certain age shall be alone thus subjected, *or all men possessed of a certain wealth.* These are distinctions which do not furnish any proper basis for the attempted classification." (Emphasis added.)

Assuming that abuses existed in derivative stockholders' actions which this statute was intended to meet, these abuses were not uniquely the characteristics of actions brought by plaintiffs holding a few shares of stock. As one commentator has remarked, "There is * * * no evidentiary support for an assumption that derivative suits brought by those holding $50,000 worth of stock or 5% thereof are more meritorious or brought in better faith than those brought by stockholders owning lesser amounts of shares or that more suits of this character are brought in bad faith by small stockholders than by larger stockholders." Zlinkoff, *The American Investor and the Constitutionality of Section 61-b of the New York Corporation Law* (1945) 54 Yale L. J. 352, 386. Or, in the words of another writer, "a legislative holding that a small shareholder's suit is presumptively a 'strike' suit not only finds no factual basis but constitutes a type of class legislation that is arbitrary, anti-social and Hamiltonian in its economic shortsightedness." Jackson, *Reorganization of the Corporate Concept and the Effect of Section 61-b of the New York General Corporation Law* (1944) 45 Corp. Reorg. & Amer. Bank. Rev. 323, 340.

B. Due Process of Law.

N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17 violate both the procedural and substantive aspects of the due process clause of the Fourteenth Amendment. Procedurally, these provisions unreasonably qualify—and in effect deny—access by certain plaintiffs to the courts for legal wrongs. Substantively, the legislation violates the due process clause by imposing arbitrary impediments, without reasonable relation to any existing abuses.

The State of New Jersey has not attempted in terms to exonerate corporate directors and officers from liability for their defalcations involving property of corporations they control. Nor in terms has it forbidden stockholders holding less than five per cent of the outstanding stocks or stocks worth $50,000 or less from bringing suit on behalf of the corporation to remedy such defalcations. But the provisions of New Jersey law, here involved, accomplish these ends as effectively as if such legislation had been passed. No plaintiff, unless he have tremendous resources, can afford to give security in the amount which the statute indicates. Nor certainly will he litigate difficult undecided questions of corporate law when, in the event he loses, he must pay expenses and counsel fees of the corporation and the individual defendants. For apart from the expenses other than counsel fees, "it is not unusual nor would it be unreasonable for defendants in such actions to retain distinguished counsel. Stockholders' actions are ordinarily directed against several defendants, each of them entitled to counsel of his own choice. The anticipated aggregate charge of several prominent law firms for services in a protracted and intricate litigation are bound to be formidable." *Citron v. Mangel Stores Corp.*, 50 N. Y. S. 2d 416, 419 (Sup. Ct. N. Y. Co., 1944). Constitutional rights may be nullified quite as readily and completely by procedural obstructions to their effective assertion and maintenance as by outright substantive denial.

The unreasonableness of the legislation at issue is best demonstrated by the discrepancy between the evils to be

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Supreme Court of the United States

OCTOBER TERM, 1948.

No.

ANNAH COHEN, Executrix of the Estate of Sol Cohen, Deceased, and DAVID F. COHEN, Intervenor,

Petitioners,

—against—

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Respondent,

—and—

. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAUL A. SEIBOLD, individually,

Defendants.

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petitioners respectfully show:

JURISDICTION.

The order of the District Court for the District of New Jersey, denying respondent's motion for security for costs including counsel fees, was entered on November 17, 1947. The judgment of the Court of Appeals for the Third Circuit, reversing the order of the District Court and remanding the cause, was entered on September 22, 1948. Jurisdiction of this Court is invoked under Title 28, §§ 1254(1) and 2101(c).

OPINIONS BELOW.

The opinion of the District Court (R. 29) is reported at 7 F. R. D. 352. The opinion of the Court of Appeals for the Third Circuit (R. 40) is reported at 170 F. 2d 44.

STATUTES AND RULES INVOLVED.

Chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17) provides as follows:

> "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action

upon showing that the security provided has or may become inadequate or is excessive.

"This act shall take effect immediately and shall apply to all such actions, suits or proceedings now pending in which no final judgment has been entered, and to all future actions, suits and proceedings."

Rule 23 of the Federal Rules of Civil Procedure provides as follows:

"(a) Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is

(1) joint, or common, or secondary in the sense that the owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it. . . .

"(b) Secondary Action by Shareholders. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because that association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and,

if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.

"(c) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. * * *"

STATEMENT.

The controversy at bar arises out of a derivative stockholder's action brought against the individual defendants on behalf of the respondent, Beneficial Industrial Loan Corporation, a Delaware corporation. Jurisdiction of the District Court for the District of New Jersey was based upon diversity of citizenship. The complaint, originally on behalf of Sol Cohen, was filed on August 9, 1943 (R. 1). On August 23, 1943, David F. Cohen was permitted to intervene as party-plaintiff (R. 1). On February 14, 1946, following the death of Sol Cohen, Hannah Cohen, his executrix, was substituted in his stead (R. 5). The petitioners own 250 shares of the common stock of the corporate defendant (R. 13).

It is unnecessary, for the purposes of this petition, to set forth the allegations contained in the original and amended complaints. It suffices to state that serious and sizable defalcations by the officers and directors of Beneficial Industrial Loan Corporation are alleged. Nor is it necessary to detail the various procedural maneuvers which took place between the time of the filing of the original complaint in August, 1943 and the motion for security for costs made by the respondent corporation in August, 1946. The only issues now before the Court arise out of or relate to that motion.

That motion was for an order directing that

> "the plaintiff and the intervener give security to defendant Beneficial Industrial Loan Corporation in the amount of not less than $125,000 for the reasonable expenses, including counsel fees, which may be incurred by said defendant in connection with this action, and for the reasonable expenses, including counsel fees, which may be incurred by the other parties defendant in connection therewith for which defendant Beneficial Industrial Loan Corporation may become subject pursuant to law or to its by-laws[1] or under equitable principles * * *." (R. 10).

The motion was based on Chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17), effective April 10, 1945. See pages 2-3, *supra*.

Judge Smith denied the motion and stated in his opinion that the relevant provisions of Chapter 131 were inapplicable to this litigation in a federal court and that, in any event, the law of Delaware, rather than that of New Jersey, would be governing as to the petitioners' liability for the respondent's expenses and counsel fees. The respondent appealed from the decision of Judge Smith to the Court of Appeals for the Third Circuit.

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[1] Article X of the by-laws of Beneficial Industrial Loan Corporation provides in part:

"The Corporation shall indemnify and hold harmless each person who shall serve at any time hereafter as a director or officer of the Corporation from and against any and all claims and liabilities to which such person shall have become subject by reason of his having heretofore or hereafter been a director or officer of the Corporation, or by reason of any action alleged to have been heretofore or hereafter taken or omitted by him as such director or officer, and shall reimburse each such person for all legal and other expenses reasonably incurred by him in connection with any such claim or liability; provided, however, that no such person shall be indemnified against, or be reimbursed for any expense incurred in connection with, any claim or liability arising out of his own negligence or wilful misconduct. The rights accruing to any person under the foregoing provisions of this Article shall not exclude any other right to which he may be lawfully entitled, nor shall anything herein contained restrict the right of the Corporation to indemnify or reimburse such person in any proper case even though not specifically herein provided for. The Corporation, its directors, officers, employees and agents, shall be fully protected in taking any action or making any payment under this Article X or in refusing so to do, in reliance upon the advice of counsel." (R. 12).

The Court of Appeals held that the order of the District Court denying security for costs was appealable. Having determined that it possessed jurisdiction over the appeal, the Court held that the provisions of Chapter 131 here at issue were enforceable in a federal court, that they were constitutional under the federal and New Jersey Constitutions, and that the retroactive application was not violative of either Constitution.

QUESTIONS PRESENTED.

1. Whether the order of the District Court for the District of New Jersey, denying respondent's motion for security for costs and counsel fees, was appealable.

2. Whether a federal court in New Jersey, whose jurisdiction is based upon diversity of citizenship, must apply the laws of New Jersey with respect to security for costs and counsel fees, in a derivative stockholders' action brought by a New York stockholder on behalf of a Delaware corporation.

3. Whether Chapter 131 of the New Jersey Laws of 1945, particularly N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17, if applicable to a federal court whose jurisdiction is based upon diversity of citizenship, violates the federal or New Jersey Constitutions.

4. Whether in its application to actions commenced prior to its enactment Chapter 131 of the New Jersey Laws of 1945, particularly N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17, if applicable in a federal court whose jurisdiction is based upon diversity of citizenship, violates the federal or New Jersey Constitutions.

REASONS FOR GRANTING THE WRIT.

1. A direct conflict exists between the Court of Appeals for the Third Circuit and the Court of Appeals for the Second Circuit, as to whether an order denying security for costs and counsel fees is appealable. In the case at bar, the Court of Appeals for the Third Circuit has held such an order appealable. In *Thompson* v. *Broadfoot & Aspinook Corporation*, decided October 17, 1947 [2] [referred to in *Aspinook Corporation* v. *Bright*, 165 F. 2d 294, 295 (C. C. A. 2d, 1948), and *Thompson* v. *Broadfoot*, 165 F. 2d 744, 745 (C. C. A. 2d, 1948)], the Court of Appeals for the Second Circuit held not appealable an order denying a motion for security made pursuant to Sections 61-b and 64 [3] of the New York General

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[2] This case is unreported. A motion was made to dismiss an appeal from the order of Judge Bright denying security for costs and counsel fees under General Corporation Law, §§ 61-b, 64. The Court (Judges A. Hand, Clark, Frank) entered the following order from which Frank, J., noted his dissent:

"Motion granted on the ground that the appeal from the order must be dismissed because the order is not final."

The Second Circuit has also held that even an order granting security is not appealable. *Donovan* v. *Queensboro Corp.*, No. 156, O. T. 1948, cert. den. October 11, 1948.

[3] § 61-b. Security for expenses.

In any action instituted or maintained in the right of any foreign or domestic corporation by the holder or holders of less than five per centum of the outstanding shares of any class of such corporation's stock or voting trust certificates, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to section sixty-four of this chapter, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter from time to time be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive.

§ 64. Assessment of expenses.

Any person made a party to any action, suit or proceeding by reason of the fact that he, his testator or intestate, is or was a director, officer or employee of a corporation shall be entitled to have his reasonable expenses, including attorneys' fees, actually and necessarily incurred by him in connection with the defense of such action, suit or proceeding, and in connection with any appeal therein, assessed against the corporation or against another corporation at the request of which he served as such director, officer or employee, upon court order, in the manner and to the extent provided by sections

Corporation Law. These provisions, as the Court of Appeals for the Third Circuit stated (R. 47), are, in effect, identical with the provisions of Chapter 131 of the New Jersey Laws of 1945 here at issue. Note (1947) 1 Rutgers U. L. Rev. 117.

2. There are conflicting rulings as to whether statutes such as Chapter 131 are applicable in diversity cases brought in the federal courts.[4] The Third Circuit recognized this conflict in its opinion in this case: "We are aware that our decision is contrary in substance to that of Aspinook Corporation v. Bright, 2 Cir., 165 F. 2d 294, and directly contrary to decisions such as Boyd v. Bell, D. C. S. D., N. Y., 64 F. Supp. 22, and the other authorities cited to the point in 165 F. 2d at p. 295." (R. 53, n. 12). In *Boyd* v. *Bell*, 64 F. Supp. 22 (S. D. N. Y., 1945), it was held that such statutes should not be enforced in a federal court. The same opinion was expressed by Judge Frank in his dissenting opinion in *Aspinook Corporation* v. *Bright*, 165 F. 2d 294, 295 (C. C. A. 2d, 1948). In *Craftsman Finance & Mortgage Co.* v. *Brown*, 64 F. Supp. 168, 178 (S. D. N. Y., 1945), it was held that application of the state statute "in any given case * * * rests in the sound discretion of the Federal Judge * * * " and the motion for security was denied. In *Donovan* v. *Queensboro Corp.*, 75 F. Supp. 131 (E. D. N. Y., 1947), the court apparently applying a rule of discretion, granted security in the sum of $50,000, and in *Gucler* v. *Bossert*, decided August 7, 1948 (S. D. N. Y.), C. C. H., N. Y. Corp. L. Rep. Par. 70,152, the Court exercised its "discretion" to grant security in the amount of $5,000. See also the Note of the Advisory Committee with reference to Rule 23(b) of the Federal Rules of

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sixty-five, sixty-six and sixty-seven of this chapter, and in the instances specified in section sixty-eight of this chapter, except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such officer, director or employee is liable for negligence or misconduct in the performance of his duties.

[4] For similar statutes in Maryland, New York, Pennsylvania and Wisconsin, see Hornstein, *New Aspects of Stockholders' Derivative Suits* (1947) 47 Col. L. Rev. 1, 5-6; Koessler, *The Stockholders' Suit: A Comparative View* (1946) 46 Col. L. Rev. 238, 249.

Civil Procedure; Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York* (1944) 32 Calif. L. Rev. 123; Hornstein, *A New Forum for Stockholders* (1945) 45 Col. L. Rev. 35; Hornstein, *New Aspects of Stockholders' Derivative Suits* (1947) 47 Col. L. Rev. 1, 11-12.

3. The constitutionality of Chapter 131 and of similar legislation in other states has been much controverted. Although the New York Court of Appeals has recently held that Section 61-b of the New York General Corporation Law is constitutional on its face, *Lapchak* v. *Baker*, 298 N. Y. 89 (1948), at least one decision of an inferior New York court had held to the contrary. *Citron* v. *Mangel Stores Corp.*, 50 N. Y. S. 2d 416 (Sup. Ct. N. Y. Co., 1944). A District Court Judge has labelled these sections "discriminatory." *Craftsman Finance & Mortgage Co.* v. *Brown*, 64 F. Supp. 165, 178 (S. D. N. Y., 1945). The constitutionality of statutes such as Chapter 131 has also engendered much discussion in the legal periodicals and it has been strongly urged by certain commentators that the legislation is unconstitutional. See Zlinkoff, *The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Law* (1945) 54 Yale L. J. 352; Hornstein, *New Aspects of Stockholders' Derivative Suits* (1947) 47 Col. L. Rev. 1, 4; Note (1947) 1 Rutgers U. L. Rev. 117. See also (1944) 58 Harv. L. Rev. 135.

In view of the dubious constitutionality of the New Jersey statute and in view of its deterrent effect upon meritorious stockholders' actions, this case is one presenting "an important question of federal law which has not been, but should be, settled by this court." Rule 38(5)(b).

4. The retroactive effect of the New Jersey statute presents additional important constitutional questions. Chapter 131 is retroactive by its terms, *i.e.*, it is applicable to suits initiated prior to the enactment of the statute. In this respect it differs from Section 61-b of the New York Corpora-

tion Law, which did not indicate whether it was to be applied to pending cases. The New York courts construed Section 61-b as being prospective only in operation, *Shielcraft* v. *Moffett*, 294 N. Y. 180 (1945), and thereby avoided the constitutional problems which would otherwise have arisen. See the dissenting opinion of Justice Callahan, in *Shielcraft* v. *Moffett*, 268 App. Div. 352 (1st Dept., 1944); Zlinkoff, *The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Law* (1945) 54 Yale L. J. 352, 390. These problems, however, as the Court of Appeals for the Third Circuit recognized, cannot be avoided under the New Jersey statute here at issue. The case at bar was commenced in 1943, and the New Jersey statute was not enacted until 1945.

ARGUMENT.

I.

THE ORDER DENYING RESPONDENT'S MOTION FOR SECURITY WAS NOT APPEALABLE.

The Court of Appeals for the Third Circuit, contrary to the decision by the Court of Appeals for the Second Circuit,[5] has held that an order denying security for costs and counsel fees is appealable.[6]

The principles underlying the "final decision" rule patently read against the appealability of the District Court order denying security for costs. In *Catlin* v. *United States*, 324 U. S. 229 (1945), this Court pointed out that a "'final decision' generally is one which ends the litigation on the merits and leaves nothing for the court to do but execute the

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[5] *Thompson* v. *Broadfoot & Aspinook Corporation*, set forth in note 2 *supra*.

[6] The opinion of the Court of Appeals, filed September 22, 1948, refers to Section 128 of the Judicial Code, 28 U. S. C. § 225. The new Title 28, effective September 1, 1948, does not modify the "final decision" rule. 28 U. S. C. § 1291.

judgment." *Id.* at 233. "The foundation of this policy is not in merely technical conceptions of 'finality.' It is one against piecemeal litigation. 'The case is not to be sent up in fragments' * * *. *Luxton* v. *North River Bridge Co.*, 147 U. S. 337. Reasons other than conservation of judicial energy sustain the limitation. One is elimination of delays caused by interlocutory appeals." *Id.* at 233-34. The Court went on to state that a decision is not reviewable "whenever the question may be saved for disposition upon review of final judgment disposing of all issues involved in the litigation or in some other adequate manner." *Id.* at 236.

The District Court order did not "end the litigation on the merits." The Court of Appeals by accepting the appeal permitted the case to come "up in fragments." And certainly the question, in so far as matters other than security are affected, "may be saved for disposition upon review of final judgment disposing of all issues involved in the litigation." In so far as security is concerned, respondent is in the same position respecting appealability as a defendant who unsuccessfully moves for security for costs against a non-resident plaintiff in a non-derivative action. These are the guiding rules that caused the Second Circuit to refuse to accept an appeal from a similar order. The reasons for rejecting these principles, offered by the Third Circuit, are clearly fallacious.

That Court purported to rely primarily upon two decisions of the Supreme Court. The first, *Trustees* v. *Greenough*, 105 U. S. 527 (1882), held that "under all the circumstances" the order of the Circuit Court granting costs, expenses and allowances "out of a trust fund under the control" of the court was appealable. On its face the case is inapplicable to the situation at bar. In the first place, the order in the case now before the Court relates not to the grant or denial of costs but to security for them. If the New Jersey statute is applicable and constitutional, respondent, regardless of any decision at this time, may be entitled to expenses and counsel fees upon the termination of the action. In the second place,

the order at bar denies security. And just as denial of a summary judgment is not appealable,[7] though the grant of summary judgment is a final decision, so here, even if we assume that an order granting security would be appealable, an order denying such security is not, since it resolves no controversy, stops no proceedings, and may be reviewed later upon an appeal from a final decision.[8]

Nor does the second case relied upon by the Court of Appeals, *Sprague* v. *Ticonic Bank*, 307 U. S. 161 (1939), support its decision. That case held a denial of a petition for counsel fees and expenses an appealable order, because the matter had never previously been in issue and because the denial or grant of such fees and expenses could not thereafter be reviewed upon a subsequent appeal, all other proceedings having been completed.

But it is not necessary to look solely to the inadequacy of the precedents cited by the Court. The New Jersey statute provides for the granting or amending of an order for security for costs at any time during the proceedings. If an order denying security is appealable, so too, on the reasoning of the Third Circuit, would be orders amending the amounts of security required. The consequences would be numerous interlocutory appeals delaying and hindering the action in contravention of the "final judgment" rule.

II.

N. J. R. S. CUM. SUPP. 14:3-15, 14:3-17, ARE NOT APPLICABLE IN A FEDERAL COURT.

It is important to note, at this time, the two distinct questions underlying the issues of this case. The first is whether a federal court, in a diversity case, must follow the procedure of requiring security to be posted in advance to which the corporation might be able to look for costs and attorneys

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[7] *Jones* v. *St. Paul Fire & Marine Ins. Co.*, 108 F. 2d 123 (C. C. A. 5, 1939); *Belmar Hats* v. *Young America Hats*, 116 F. 2d 956 (C. C. A. 2, 1941); *Drittel* v. *Friedman*, 154 F. 2d 653 (C. C. A. 2, 1946).

[8] *Catlin* v. *United States*, 324 U. S. 229, 236 (1945).

fees in the event that the individual defendants prevail in the action. The second is whether the federal court must award a corporation costs and expenses upon the failure of the plaintiffs to prove their cause of action. The questions are distinct for the reason that even if a plaintiff might ultimately be liable for fees and expenses by reason of the New Jersey statute, the New Jersey procedure of providing security from which those fees and expenses would be paid would not have to be adopted. On the other hand, it would be futile to rule that the security must be posted in advance unless the corporation might be entitled to reimbursement for the fees and expenses provided for in the New Jersey statute. Thus, only if the Court should rule that the first question must be answered in the affirmative need it look to the second. If the Court rules, as it should, that the posting of security in advance is a procedural matter not binding on a federal court the second question need not concern it at this time. Discussion of the second question and the necessary historical inquiry as to whether expenses and legal fees are "substantive" or "procedural" will, therefore, be postponed to the brief on the merits.

Whether a bond is to be posted in advance is clearly a question of procedure which, even in diversity cases is not controlled by state rules. Admittedly the dichotomy between procedure and substance is based on a wavering line. But for the purposes of *Erie R. R.* v. *Tompkins*, 304 U. S. 64 (1938), and the Rules of Decisions Act, 28 U. S. C. § 1652, this Court has set down the distinguishing line. Thus, in *Guaranty Trust Co.* v. *York*, 326 U. S. 99, 109 (1945), the distinction was stated in this way:

> "And so the question is not whether a statute of limitations is deemed a matter of 'procedure' in some sense. The question is whether such a statute concerns merely the manner and the means by which a right to recover, as recognized by the State, is enforced, or whether such a statutory limitation is a matter of substance in the aspect that alone is rele-

cured and the "remedies" adopted by the statute. The principal wrongs that may arise in stockholders' suits are (1) the bringing of a suit without any reasonable basis in order to secure a payment to prevent harassment; (2) the private settlement of suits either to avoid such harassment or to buy off the revelation of the wrongdoing that the action would bring into the open; (3) the large costs that a corporate defendant must incur to defend groundless suits.

The statute, however, makes no distinction between groundless suits and suits based on reasonable grounds; it does not prevent the secret settlements by means of which meritorious suits are prevented from being carried to a successful conclusion or non-meritorious suits are simply bought off by the defendants; it does not provide for the reimbursements of large costs incurred in the defense of a groundless suit unless the plaintiff owns less than a specified amount of stock—a distinction already shown to be arbitrary.

The distinction between the alleged bases for the statute and the unstated real premises is further ascertained by the difference between the legislation as enacted and the remedies available to the legislature if its purpose were what it pretends to be. The New Jersey legislature could have subjected all plaintiffs in stockholders' actions to liability for expenses upon a judicial finding of lack of good faith, *cf.* e.g., Section 11(e) of the Securities Act of 1933 as amended, 11 U. S. C. § 77(k)(e).; it could have outlawed secret settlements either by requiring notice to all shareholders or by insisting upon judicial approval. These remedies it could have chosen, in addition to more radical improvements such as granting to an administrative agency powers of scrutiny over corporate transactions and of enforcement of private rights. That it legislated as it did, despite the multiple choices open to it, indicates that the statute was intended, not as a correction of abuses but as a "death knell" of the small stockholders' only remedy for corporate wrongs, an objective which it could not openly seek or achieve without running afoul of the Fourteenth Amendment's due process clause.

C. Full Faith and Credit.

In so far as N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17 apply to actions by residents of other states on behalf of foreign corporations, they violate the full faith and credit clause of the federal Constitution and are an attempt by the State of New Jersey to affect relationships in which it has no interest and over which it has no control. They create the very barriers which "it has been the whole course of our law to break down * * * against calling corporations to account in all states where they may do wrong in doing business." Mr. Justice Reed dissenting in *Koster* v. *Lumbermen's Mutual Casualty Co.*, 330 U. S. 518, 538 (1947).

Although *United Commercial Travelers* v. *Wolfe*, 331 U. S. 586 (1946), was limited to a denial of the power of South Dakota to impose its statute of limitations with respect to a fraternal benefit society organized in Ohio, the policy behind that decision restricting the law of the forum is applicable to the New Jersey statute. The relationship between the corporation, the stockholders, and the officers and directors is created by Delaware law. It is from the right of incorporation which Delaware statutory law confers that the rights and liabilities of the respective parties spring. Even if they arise from decisional rather than enacted law it does not matter; for "what is entitled in proper cases to full faith and credit is the law of a state by whatever source declared." Jackson, *Full Faith and Credit—The Lawyers' Clause of the Constitution* (1945) 45 Col. L. Rev. 1, 12. The analogy to *Broderick* v. *Rosner*, 294 U. S. 629 (1935), is a very close one. In that case, New Jersey attempted by statute to bar an action, brought by the Superintendent of Banks of New York, against New Jersey residents, who were stockholders in the Bank of the United States, to recover assessments levied by him in accordance with the law of New York, where the banking corporation had been organized. Mr. Justice Brandeis for the Court held that the New Jersey law could not govern. As he stated, "Obviously recognition could not be accorded to a local policy of New Jersey, if these really

were one; of enabling all residents of the State to escape from the performance of a voluntarily assumed statutory obligation, consistent with morality * * *.'" 294 U. S. at 644.

IV.

THE RETROACTIVE APPLICATION OF N. J. R. S. CUM. SUPP. 14:3-15, IN ACCORDANCE WITH THE TERMS OF N. J. R. S. CUM. SUPP. 14:3-17, VIOLATES THE FEDERAL CONSTITUTION.[12]

The retroactive application of the provisions of Chapter 131, here at issue, since they would effectively destroy the sole remedy of the stockholder to prevent the defalcations of officers and directors, violates the federal Constitution in the following respects:

A. Due Process of Law.

When a corporation has refused a proper demand to remedy wrongs done it or when such a demand would be futile, equity confers upon the stockholders a cause of action in the corporation's right. *Koster* v. *Lumbermen's Mutual Casualty Co.*, 330 U. S. 518 (1947). This cause of action is a property right, *Citron* v. *Mangel Stores Corp.*, 50 N. Y. S. 2d 416 (Sup. Ct. N. Y. Co., 1944), as are other vested rights of action. *Pritchard* v. *Norton*, 106 U. S. 124, 132 (1882). To the extent it is not prosecuted, the shareholder's proportionate interest in the corporation is diminished.

At the time of the enactment of Chapter 131 this property right had fully ripened. The wrongs had been committed;

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[12] We do not at this time present argument with respect to the constitutionality of the retroactivity of N. J. R. S. Cum. Supp. 14:3-15 in accordance with the terms of N. J. R. S. Cum. Supp. 14:3-17, under either the New Jersey Constitution of 1844, which was in effect at the time of the passage of these provisions or under the New Jersey Constitution of 1947 which subsequently became effective. But we reserve our right to do so, in the event that certiorari is granted.

the corporation's assets had been diminished by the misdeeds of the defendants; suit had been instituted.

> "* * * A statute, under the form of taking away or changing a particular remedy, may take away an existing property right, or impair the obligation of contract." *Ettor v. Tacoma*, 228 U. S. 148, 155 (1913).

Whatever may be the power of the state to modify or repeal remedies and whatever its power may be to abolish old rights "recognized by the common law, to obtain a permissible legislative object," *Silver v. Silver*, 280 U. S. 117, 122 (1929), the state may not destroy all remedies to enforce a pre-existing cause of action. *Ettor v. Tacoma, supra.* What Mr. Justice Holmes stated in *Forbes Pioneer Boat Line v. Board of Commissioners*, 258 U. S. 338, at 339, 340 (1922), is wholly applicable to this case.

> "Stripped of conciliatory phrases the question is whether a state legislature can take away from a private party a right to recover money that is due when the act is passed."
>
> * * * * *
>
> "Defendant owed the plaintiff a definite sum of money that it had extorted from the plaintiff without right. It is hard to find any ground for saying that the promise of the law that the public force shall be at the plaintiff's disposal is less absolute than it is when the claim is for goods sold."

B. Impairment of Contract.

Under the law evidenced by such cases as *Coombes* v. *Getz*, 285 U. S. 434 (1932), and *Hathorn* v *Calef*, 2 Wall. 10 (1865), the retroactive effect of the New Jersey provisions of law here at issue impairs the obligation of contract. The petitioners' relationship with the respondent corporation was, of course, contractual. Part of that contract was the right given them by Delaware law to bring a derivative action for wrongs to the corporation; for "the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms." *Van Hoffman* v. *Quincy*, 4 Wall. 535, 550 (1867), quoted in *Wood* v. *Lovett*, 313 U. S. 363, 370 (1941). See *Coombes* v. *Getz, supra.* The law so incorporated may be non-statutory, *Bronson* v. *Kenzie*, 1 How. 311, 319 (1843), as well as statutory.

New Jersey, by attempting to deprive petitioners of the benefit of the law under which they contracted, has impaired that contract.

CONCLUSION.

For the reasons heretofore set forth, petitioners respectfully submit that this Court issue a writ of certiorari to the Court of Appeals for the Third Circuit to review this case.

Respectfully submitted,

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Supreme Court of the United States

OCTOBER TERM, 1948.

No. 512

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Petitioner,

against

Honorable WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey; and HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Interveners,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

JOHN M. HARLAN,
CHARLES DANZIG,
Counsel for Petitioner.

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Supreme Court of the United States

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner Beneficial Industrial Loan Corporation respectfully prays that in the event that this Court should grant the petition for certiorari in the case of *Cohen* v. *Beneficial Industrial Loan Corporation*, No. 442, October Term, 1948, submitted simultaneously herewith, a writ of certiorari issue to the United States Court of Appeals for the Third Circuit, to review a final judgment of said Court in a case entitled *Beneficial Industrial Loan Corporation, Petitioner, and Hannah Cohen, Executrix of the Estate of Sol Cohen, deceased, and David F. Cohen, Interveners* v. *Hon. William F. Smith.*

Opinion Below.

The opinion of the Court of Appeals is reported in 170 F. (2d) 44 and is printed on pages 40-61 of the Record in No. 442.

Statutes Involved.

Section 262 of the Judicial Code (36 Stat. 1162, 28 U. S. C. §377) provided as follows:

> "The Supreme Court and the district courts shall have power to issue writs of scire facias. The Supreme Court, the circuit courts of appeals, and the district courts shall have power to issue all writs not specifically provided for by statute, which may be necessary for the exercise of their respective jurisdictions, and agreeable to the usages and principles of law."

In the 1948 revision of Title 28 of the United States Code, this provision is found in 28 U. S. C. §1651(a), which reads as follows:

> "The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions agreeable to the usages and principles of law."

Statement of Matter Involved.

This petition is in the nature of a cross-petition to the petition in *Cohen v. Beneficial Industrial Loan Corporation*, No. 442, October Term, 1948, to bring before this Court a certain point not raised in No. 442. As will be shown immediately, this point will be reached for consideration by this Court only in the event that the petition for certiorari in

No. 442 is granted and that this Court should hold on the merits that the order of the District Court, which was reversed on appeal by the Court of Appeals for the Third Circuit, was not directly appealable.

Since the background of this case has been set forth on pages 3-5 of our brief in opposition to the petition in No. 442, we shall limit this statement to the additional point raised by this petition.

As appears from the opinion of the Court of Appeals (R. 43 in No. 442), petitioner Beneficial Industrial Loan Corporation appealed from the order of the District Court denying its motion under Chapter 131 of the New Jersey Laws of 1945, since it seemed clear that the order was a final appealable decision, and the Court of Appeals so held. However, in view of the fact that the New Jersey statute was new and had at that time never been the subject of appellate review in the federal courts, the petitioner in the alternative filed in the Court of Appeals a petition for a writ of certiorari or a writ of mandamus (R. 2-9), in order to protect its right to appellate review in the event that the Court of Appeals should hold the order not to be appealable.

The Court of Appeals held the order of the District Court to be appealable, and consequently entered a decree dismissing the petition for the writs (R. 43).

The petition in No. 442 seeks, among other things, a review by this Court of the holding by the Court of Appeals that the order of the District Court was subject to direct appeal. It follows that in the event that this Court should grant the petition in No. 442, petitioner Beneficial Industrial Loan Corporation would be faced by the same necessity for an alternative protection of its rights as in the court below. While believing that the decision of the court below was correct, petitioner desires to protect its right

to appellate review of the order of the District Court in the event that this Court should hold that the order was not appealable. In that event only, it seeks by this petition review of the decree of the Court of Appeals dismissing its petition for mandamus or certiorari.

Jurisdiction.

The jurisdiction of this Court is invoked under 28 U. S. C. §1254(1). The decree of the Court of Appeals dismissing the petition for a writ of certiorari or a writ of mandamus was entered on September 22, 1948 (R. 43). By order dated December 10, 1948, Mr. Justice Burton has extended the time for filing this petition to and including January 15, 1949 (R. 44).

Question Presented.

If the order of the District Court was not directly appealable, was it reviewable by writ of mandamus or writ of certiorari?

Reasons Relied on for the Allowance of the Writ.

1. The instant petition performs the function of a cross-petition to No. 442 and merely seeks to bring before this Court an aspect of the decision of the court below which has not been raised by the petitioners in No. 442. The decision of the court below as to review by common law writ was inextricably intertwined with its decision on appealability, and one was dependent upon the other. Therefore, if this Court should grant the petition in No. 442, this cross-petition should likewise be granted so that the entire question of the reviewability of the order of the District

Court may be determined by this Court and the corporate petitioner may obtain relief from a possible prejudicial error of the court below.

2. The dismissal of the petition for mandamus or certiorari by the court below was clearly erroneous, if the order of the District Court was not directly appealable.

(a) The dismissal was based on the ground that the order was appealable, the court saying (R. 61 in No. 442):

> "Our decision makes it unnecessary for this court to pass upon Beneficial's application for mandamus or certiorari. Consequently an order will be entered . . . dismissing the petition."

Since the remedy by appeal was adequate, no reason existed for the issuance of a prerogative writ. If this Court should hold that the court below erred as a matter of law in deciding that the order of the District Court was directly appealable, it follows that the dismissal of such petition was based on an error of law.

(b) It is clear that if the order was not appealable, the court below would have granted the petition for the writs, if it had the power to do so. Thus, the court below said in its opinion (R. 44 in No. 442):

> ". . . *without the right to sustain an appeal Beneficial could never gain the security to which it is entitled if the statute is applicable*, for a writ of mandamus could issue from this court only in aid of its appellate jurisdiction. [Citations omitted] If the order of the court below is not appealable we would not have the right to issue the writ since inso far as the instant litigation is concerned this court would have no appellate jurisdiction to protect." (Emphasis supplied.)

The doubt of the court below as to its *power* to review the order of the District Court by common law writ, if the order was not reviewable by *direct* appeal, is clearly unfounded. There can be no doubt as to its power to do so under section 262 of the Judicial Code, which then appeared in 28 U. S. C. §377, but is now found in 28 U. S. C. §1651(a). For the order of the District Court would have been reviewable in any event on appeal from its final judgment. And it is well settled that where, as in this case, such an appeal would be wholly ineffectual, the common law writs may be issued in aid of such potential appellate jurisdiction, before actual appellate jurisdiction has been obtained. *McClellan* v. *Carland*, 217 U. S. 268 (1910); *Ex parte United States*, 287 U. S. 241 (1932).

As shown on pages 8-11 of the brief in opposition to the petition in No. 442, and as recognized by the court below, the order of the District Court is beyond correction after final judgment in the main action and appellate jurisdiction would thus be thwarted if review is postponed until then.

On the basis of such circumstances, this Court in the case of *De Beers Consolidated Mines* v. *United States*, 325 U. S. 212 (1945), granted a common law writ of certiorari to review an interlocutory order of the District Court which restrained the defendants in an anti-trust suit from disposing of any of their property in the United States during the pendency of the action and until their compliance with any decree rendered against them. Mr. Justice Roberts, delivering the opinion of the court, said (at p. 217):

> ". . . no decision of the suit on the merits can redress any injury done by the order; and therefore unless it can be reviewed under §262 it can never be corrected if beyond the power of the court below."

This is precisely the situation here, if the order is held to be interlocutory in character.

Appellate jurisdiction may also properly be protected in the instant case by the issuance of a writ of mandamus. Chapter 131 of the New Jersey Laws of 1945 gives to corporations an absolute right to require a stockholder owning less than the required number of shares to give security for counsel fees and expenses and an absolute right to have recourse therefo in the event that the plaintiff-stockholder is unsuccessful. As the Court of Appeals stated in its opinion, ". . . the wording of R. S. 14:3-15 leaves no discretion in the court below to require security of the plaintiff or the intervener. The only discretion conferred on the court by R. S. 14:3-15 is as to the *amount* of the security and of the subsequent reimbursement" (R. 60, in No. 442). In the instant case, the District Court refused to fix the security to be posted by the plaintiff and intervener, which was its mandatory duty under the statute, and held that it was without jurisdiction to allow counsel fees and expenses. Under these circumstances, mandamus was a proper remedy to direct the District Court to exercise its jurisdiction and to fix the amount of security as required by the statute.

A case directly in point is *Ex parte United States*, 287 U. S. 241 (1932). There, the District Court had denied the government's petition for a bench warrant for the arrest of a person duly indicted by the grand jury. This Court granted mandamus to review the order, saying (at p. 249):

> "The theory of the court below is that its denial of the petition of the government for a bench warrant was an exercise of its judicial discretion, and, therefore, not reviewable by mandamus. This view of the matter cannot be sustained. The question whether there was probable cause for putting the

accused on trial was for the grand jury to determine, and the indictment being fair on its face, the court to which it was returned, upon the application of the United States attorney, should have issued the warrant as a matter of course."

Here, likewise, the District Court had no discretion in the matter, but should have ordered the posting of security by the plaintiff and intervener "as a matter of course", and its failure to do so, if not appealable, should have been corrected by the Court of Appeals in the exercise of the powers conferred upon it by 28 U. S. C. § 1651(a).

WHEREFORE, it is respectfully submitted that this cross-petition for certiorari to review the decision of the Court of Appeals dismissing the petition for mandamus or certiorari should be granted, in the event that this Court should grant the petition in No. 442.

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Counsel for Petitioner.

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Supreme Court of the United States

OCTOBER TERM, 1948.

No. 442.

HANNAH COHEN, Executrix of the Estate of Sol Cohen, Deceased, and David F. Cohen, Intervenor,

Petitioners,

—against—

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Respondent,

—and—

C. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAULA A. SEIBOLD, individually,

Defendants.

No. 512.

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Petitioner,

—against—

Honorable William F. Smith, a Judge of the United States District Court for the District of New Jersey; and HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and David F. Cohen, Intervenor,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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Supreme Court of the United States

OCTOBER TERM, 1948.

No. 442.

HANNAH COHEN, Executrix of the Estate of Sol Cohen, Deceased, and DAVID F. COHEN, Intervenor,

Petitioners,

—against—

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Respondent,

—and—

C. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FEETER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAULA A. SEIBOLD, individually,

Defendants.

No. 512.

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Petitioner,

—against—

Honorable WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey; and HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenor,

Respondents.

BRIEF FOR PETITIONERS IN NO. 442, O.T. 1948—BRIEF FOR RESPONDENTS HANNAH COHEN AND DAVID F. COHEN IN NO. 512, O.T. 1948.

Opinions Below.

The opinion of the District Court (R. 22) is reported at 7 F.R.D. 352. The opinion of the Court of Appeals for the Third Circuit (R. 30) is reported at 170 F. 2d 44.

Jurisdiction.

The judgment of the Court of Appeals for the Third Circuit, reversing the order of the District Court and remanding the cause, was entered on September 22, 1948. The petition for a writ of certiorari in No. 442 was filed December 2, 1948 and was granted February 28, 1949.

The judgment of the Court of Appeals for the Third Circuit dismissing the petition for a writ of certiorari or a writ of mandamus was entered on September 22, 1948. Following an order by Mr. Justice Burton extending the time, the petition for a writ of certiorari in No. 512 was filed January 14, 1949 and was granted February 28, 1949.

Statutes Involved.

The statutory provisions involved are set forth in Appendix A, pages 36-38.

Statement.

The controversy at bar arises out of a derivative stockholder's action brought against the individual defendants on behalf of the respondent [1] Beneficial Industrial Loan Corporation, a Delaware corporation. Jurisdiction of the District Court for the District of New Jersey was based upon diversity of citizenship. The complaint, originally on behalf of Sol Cohen, was filed on August 9, 1943 (R. 1). On August 23, 1943, David F. Cohen was permitted to intervene as party-plaintiff (R. 1). On February 14, 1946, following the death of Sol Cohen, Hannah Cohen, his executrix, was

[1] The parties will be designated herein by their titles in No. 442, *i.e.*, plaintiffs in the District Court will be referred to as "petitioners" and Beneficial Industrial Loan Corporation will be referred to as "respondent."

substituted in his stead (R. 5). The petitioners own 250 shares of the common stock of the corporate defendant (R. 11).

It is unnecessary to set forth here the allegations contained in the original and amended complaints. It suffices to state that serious and sizable defalcations by the officers and directors of Beneficial Industrial Loan Corporation are alleged. Nor is it necessary to detail the various procedural maneuvers which took place between the time of the filing of the original complaint in August, 1943 and the motion for security for costs made by the respondent corporation in August, 1946, except to say that there had been lengthy pre-trial discovery proceedings. The only issues now before the Court arise out of or relate to that motion.

That motion was for an order directing that

> "the plaintiff and the intervener give security to defendant Beneficial Industrial Loan Corporation in the amount of not less than $125,000 for the reasonable expenses, including counsel fees, which may be incurred by said defendant in connection with this action, and for the reasonable expenses, including counsel fees, which may be incurred by the other parties defendant in connection therewith for which defendant Beneficial Industrial Loan Corporation may become subject pursuant to law or to its by-laws [2] or under equitable principles * * *." (R. 9)

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[2] Article X of the by-laws of Beneficial Industrial Loan Corporation provides in part:

"The Corporation shall indemnify and hold harmless each person who shall serve at any time hereafter as a director or officer of the Corporation from and against any and all claims and liabilities to which such person shall have become subject by reason of his having heretofore or hereafter been a director or officer of the Corporation, or by reason of any action alleged to have been heretofore or hereafter taken or omitted by him as such director or officer, and shall reimburse each such person for all legal and other expenses reasonably incurred by him in connection with any such claim or liability; provided, however, that no such person shall be indemnified against, or be reimbursed for any expense incurred in connection with, any claim or liability arising out of his own negligence or wilful misconduct. The rights accruing to any person under the foregoing provisions of this Article shall not exclude any other

The motion was based on Chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17). See pp. 36-37, *infra*.

Judge Smith denied the motion and stated in his opinion that the provisions of Chapter 131 were inapplicable to this litigation in a federal court and that, in any event, the law of Delaware, rather than that of New Jersey, would be governing as to the petitioners' liability for the respondent's expenses and counsel fees. The respondent appealed from the decision of Judge Smith to the Court of Appeals for the Third Circuit. At the same time the respondent petitioned that Court for a writ of certiorari or of mandamus.

The Court of Appeals held that the order of the District Court denying security for costs was appealable. Having determined that it possessed jurisdiction over the appeal, the Court held that the provisions of Chapter 131 here at issue were enforceable in a federal court, that they were constitutional under the federal and New Jersey Constitutions, and that the retroactive application was not violative of either Constitution. The Court of Appeals also held that the petitions for certiorari or mandamus should be dismissed. Petitions for certiorari were filed by both the plaintiffs and the corporate defendant, and both petitions were granted.

Questions Presented.

1. Whether the order of the District Court for the District of New Jersey, denying the corporate defendants' motion for security for costs and counsel fees, was appealable.

2. Whether the order of the District Court denying the corporate defendants' motion for security for costs and counsel fees was reviewable by the Court of Appeals upon a petition for writ of mandamus or certiorari.

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right to which he may be lawfully entitled, nor shall anything herein contained restrict the right of the Corporation to indemnify or reimburse such person in any proper case even though not specifically herein provided for. The Corporation, its directors, officers, employees and agents, shall be fully protected in taking any action or making any payment under this Article X or in refusing so to do, in reliance upon the advice of counsel." (R. 10)

3. Whether a federal court in New Jersey, whose jurisdiction is based upon diversity of citizenship, must apply the laws of New Jersey with respect to security for costs and counsel fees, in a derivative stockholders' action brought by a New York stockholder on behalf of a Delaware corporation.

4. Whether Chapter 131 of the New Jersey Laws of 1945, particularly N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17, if applicable to a federal court whose jurisdiction is based upon diversity of citizenship, violates the federal Constitution.

5. Whether in its application to actions commenced prior to its enactment Chapter 131 of the New Jersey Laws of 1945, particularly N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17, if applicable to a federal court whose jurisdiction is based upon diversity of citizenship, violates the federal Constitution.

Summary of Argument.

The court below was in error in reviewing the order of the District Court denying security for expenses and attorneys' fees. That order was not a final judgment, nor was it appealable under any exception to the final judgment rule. Not having jurisdiction over any appeal, the Court of Appeals could not—probably as a matter of power and certainly as a matter of discretion—review the order by writ of mandamus.

The District Court was correct upon the merits of the case. Chapter 131 is not applicable to a federal court. In the first place, it is "procedural" under the *Erie R. R.* v. *Tompkins* rule. In the second place, the New Jersey statutes are directed to the question of good faith of plaintiffs in bringing derivative actions; Congress and this Court have already created a system to assure plaintiffs' integrity in maintaining such suits: Rule 23 of the Federal Rules of Civil Procedure.

If, however, the provisions of Chapter 131 at issue are held to be binding on a federal court, this Court must hold that they violate the equal protection and the due process clauses of the federal Constitution as being discriminatory as between plaintiffs, an undue burden on the right of certain litigants to invoke the judicial process, grossly unfair, and completely and unreasonably unrelated to the supposed evils of derivative suits. Moreover, the full faith and credit clause requires the application of Delaware and not of New Jersey law, Delaware being the state of incorporation and the source of the rights sued upon.

But apart from their general unconstitutionality, the provisions of the law at issue here, because of their retroactivity, violate the due process clause of the Fourteenth Amendment and the contract clause. They represent an effort, unique in the history of this Court, to deprive some but not all similarly situated suitors of a cause of action already invoked.

ARGUMENT.

I. THE ORDER DENYING RESPONDENT'S MOTION FOR SECURITY FOR COSTS WAS NOT APPEALABLE.

The constitutional and federal issues presented by this case are difficult and sensitive of solution. They would never have arisen had not the Third Circuit overextended its reach. This litigation thus presents a practical illustration of the wisdom of the final judgment rule: the incidental issues here presented will have taken almost three years to resolve, while the merits of the suit remain unconsidered.

The threshhold question thus goes to the jurisdiction of the Court of Appeals to entertain so obviously an interlocutory order as that of the District Court denying respondent's motion for security for costs. Contrary to the holding of the

Second Circuit,[3] the Third Circuit ruled that the order was a "final decision" and, therefore, appealable.

The limitation of review by the Court of Appeals to "final decisions" of the District Courts is statutory and jurisdictional. 28 U. S. C. § 1291. The question of what is a "final decision" and the policy of Congress behind the rule has been set forth in many opinions of this Court.

> "Finality as a condition of review is an historic characteristic of federal appellate procedure. It was written into the first Judiciary Act and has been departed from only when observance of it would practically defeat the right to any review at all. Since the right to a judgment from more than one court is a matter of grace and not a necessary ingredient of justice, Congress from the very beginning has, by forbidding piecemeal disposition on appeal of what for practical purposes is a single controversy, set itself against enfeebling judicial administration. Thereby is avoided the obstruction to just claims that would come from permitting the harassment and cost of a succession of separate appeals from the various rulings to which a litigation may give rise, from its initiation to entry of judgment. To be effective, judicial administration must not be leaden-footed. Its momentum would be arrested by permitting separate reviews of the component elements in a unified cause. * * * *"
>
> "In thus denying to the appellate courts the power to review rulings at *nisi prius*, generally, until after the entire controversy has been concluded. Congress has sought to achieve the effective conduct of litigation. For purposes of appellate procedure, finality—

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[3] *Thompson* v. *Broadfoot & Aspinook Corporation* (2d Cir., 1947). The case is unreported, but referred to in *Aspinook Corporation* v. *Bright*, 165 F. 2d 294, 295 (2d Cir., 1948). The entire opinion in the *Thompson* case reads: "Motion granted on the ground that the appeal from the order must be dismissed because the order is not final." Judge Frank noted his dissent from this decision in which Judges A. N. Hand and Clark participated.

> the idea underlying 'final judgments and decrees' in the Judiciary Act of 1789 and now expressed by 'final decisions' in § 128 of the Judicial Code—is not a technical concept of temporal or physical termination. It is the means for achieving a healthy legal system. As an instrument of such policy the requirement of finality will be enforced not only against a party to the litigation but against a witness who is a stranger to the main proceeding. Neither a party nor a non-party witness will be allowed to take to the upper court a ruling where the result of review will be 'to halt in the orderly progress of a cause and consider incidentally a question which has happened to cross the path of such litigation. . . .' Mr. Chief Justice Taft, in Segurola v. United States, 275 U. S. 106." *Cobbledick* v. *United States*, 309 U. S. 323, 324-25, 326 (1940).

And again in *Catlin* v. *United States*, 324 U. S. 229, 233 (1945), this Court stated its definition: "a 'final decision' generally is one which ends the litigation on the merits and leaves nothing for the Court to do but execute the judgment."

Little need be said to demonstrate that the order denying the motion for security for costs fulfills none of the requirements of a "final decision." To evade the patently applicable principles which demonstrate the absence of jurisdiction in the Court of Appeals, however, respondent urges that the order finally resolved an entirely separable controversy unrelated to the rest of the case. But in seeking to invoke the support of cases holding completely separable controversies appealable, it chooses to overlook the fundamental factor existent in those cases but not in this one: that the question must be so distinct and unrelated to the other issues in the case that further proceedings in the trial court can have no effect on the question sought to be appealed. The question raised by respondent's appeal, however, is so intertwined with the merits that it may be rendered moot by

later action of the trial court. For in the event the plaintiffs prevail on the merits no question of liability for costs need be considered.

Respondent has cited cases allegedly in support of its separable controversy position. But in none of the cases heretofore cited by the respondent could further action in the trial court have any impact on the questions appealed. For example, in *Sprague* v. *Ticonic Bank*, 307 U. S. 161 (1939) no further proceedings in the trial court were possible; the substantive issues in the litigation had previously been resolved. In *United States* v. *River Rouge Improvement Co.*, 269 U. S. 411 (1926) further proceedings as to other owners could not moot or otherwise affect the awards in appeal. "The controversy as to the gas main is entirely distinct from those as to riparian lands; and its result can have no bearing whatsoever upon the awards to the landowners." *Id.* at 413-414. In *Ex parte Tiffany*, 252 U. S. 32 (1920) nothing in the further action by the trial court could have impact on whether the state receiver or federal receiver was to retain the property. In *Gumbel* v. *Pitkin*, 113 U. S. 545 (1885) no matter what the trial proceeded to resolve, the question presented by the intervener would have to be decided. And in *Trustees* v. *Greenough*, 105 U. S. 527 (1882), the award of fees was not subject to change by reason of the subsequent conduct of the case in the trial court.

Trustees v. *Greenough*, *supra*, so heavily relied upon by both the respondent and the Third Circuit is irrelevant for additional reasons. *Greenough* related to costs, not security, as does this case. The decision in *Greenough* granted an absolute and immediate right to the costs awarded, while in this case the right to costs, if any, and the amount thereof, are contingent on further events at the trial. And finally the order at bar is a denial of security—not a grant, so that even if we assume that an order granting security, like an order granting summary judgment, is appealable, an order denying such security is not, since it resolves no controversy, stays no proceedings and may ultimately be reviewed on appeal.

What respondent is contending here is that the District Court order deprives it of reimbursement for counsel fees and expenses for which it may never be liable and to which it may never be entitled. The lack of "finality" in such a decision is self-evident. In the event no security is required of petitioners and final judgment is in favor of the defendants, the respondent will then be able to appeal from the District Court judgment should it deny respondent a right to reimbursement for counsel fees and expenses.[4] Should the Court of Appeals at that time rule that the respondent is entitled to reimbursement for counsel fees and expenses, it can eliminate the contrary "final judgment" of the District Court, which respondent looks upon as a potential bar to its recovery.

The wisdom of the "final decision" rule is made evident by the very terms of the New Jersey statute under attack here. For if the denial of security is an independent decision, so too on the reasoning of respondent and the Third Circuit, would be an order fixing the amount of the security or amending or refusing to amend it. The necessary consequences of numerous interlocutory appeals may be a parade of horribles, but they are not imaginary.

II. MANDAMUS IS NOT AVAILABLE TO REVIEW THE DENIAL OF THE MOTION FOR SECURITY FOR COSTS.

Inasmuch as the order denying security for costs was not appealable, the Court of Appeals properly refused to grant mandamus.

The use of extraordinary writs lies in an area where power and discretion merge. This Court has held that an intermediate federal court can grant auxiliary writs only when there is an appellate proceeding pending in the court. *Whit-*

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[4] *Newton v. Consolidated Gas Co.*, 265 U. S. 78 (1924); *Mason v. Pewabic Mining Co.*, 153 U. S. 361 (1894); *Watling v. Norfolk Southern Ry. Co.*, 162 F. 2d 95 (4th Cir., 1947); *Harris v. Twentieth Century Fox Film Corporation*, 139 F. 2d 571 (2d Cir., 1943).

ney v. *Dick*, 202 U. S. 132 (1906); *Adams* v. *United States*, 317 U. S. 269 (1942).[5] The one stated exception to this rule is that where the action of the trial court might otherwise defeat the right of the Court of Appeals to review a case, mandamus may be granted. "Otherwise the appellate jurisdiction could be defeated and the purpose of the statute authorizing the writ thwarted by unauthorized action of the district court obstructing the appeal." *Roche* v. *Evaporated Milk Ass'n.*, 319 U. S. 21, 25 (1943) and cases cited.

Yet despite the clarity of the rule and the logic of its exception into which this case does not fall, cases can be found where the Court has held that the Court of Appeals had *power* to grant mandamus, although no appeal had been taken and although no appellate jurisdiction would have been frustrated. Such a case indeed is *Roche* v. *Evaporated Milk Ass'n.*, *supra*, and *Ex parte Peru*, 318 U. S. 578 (1943) also assumes power in the Court of Appeals. But see *United States* v. *Bondy*, 174 F. 2d 642 (2d Cir., 1948), denying the existence of such power.

Whether the Court of Appeals possessed power in the strict sense is, therefore, questionable. The impropriety of the exercise of that power, however, is not.

Mandamus, as an extraordinary remedy, is "reserved for really extraordinary causes." *Ex parte Fahey*, 332 U. S. 258, 260 (1947). "[W]here, as here the statutory scheme permits appellate review of interlocutory orders only on appeal from the final judgment, review by certiorari or other extraordinary writ is not permissible in the face of the plain indication of the legislative purpose to avoid piecemeal reviews." *United States Alkali Export Ass'n* v. *United States*, 325 U. S. 196, 203 (1945) and cases cited.

At the most the action of the District Court was "a mere error in the exercise of conceded judicial power", not "usurpation of power". *De Beers Consolidated Mines* v. *United States*, 325 U. S. 212, 217 (1945). As such, it can be corrected upon appeal. To be sure, if the defendant wins

[5] A similar limitation does not bind this Court. See *Los Angeles Brush Manufacturing Corp* v. *Jones*, 272 U. S. 701 (1927); *Ex parte Peru*, 318 U. S. 578, 590 (1943). *Whitney* v. *Dick* may explain why a narrower power is imputed to the intermediate federal courts.

and if the District Court does not impose expenses and attorneys' fees upon the petitioners, the defendant may be forced to appeal so much of the decision of the District Court that denies it the right to expenses and attorneys' fees.[8] "But that inconvenience is one which we must take it Congress contemplated in providing that only final judgments should be reviewable. Where the appeal statutes establish the conditions of appellate review an appellate court cannot rightly exercise its discretion to issue a writ whose only effect would be to avoid these conditions and thwart the Congressional policy against piecemeal appeals * * *." *Roche* v. *Evaporated Milk Ass'n*, *supra*, at 30. Indeed, in the *Roche* case itself the possibility of a lengthy and expensive criminal trial was held not to justify mandamus.

Nor is mandamus available because the respondent will not have been given security for its expenses and attorneys' fees. The extreme contingency that *if* plaintiffs lose their case and *if* it is held that they are assessable for expenses and attorneys' fees, that they may not be able to satisfy that liability cannot justify interference with the trial of this case by interlocutory and extraordinary proceedings; just as mandamus would not be justified to review a denial of a plaintiff's motion for summary judgment upon a claim that defendant might be insolvent by the end of the case. To grant mandamus on this ground would mean that if a court did grant security, but the corporate defendant felt it was not sufficient, efforts would be made to obtain a writ of mandamus from a higher court to force an increase. Such a holding would result in exactly that kind of interference with trials that the final judgment rule and the limitation upon extraordinary writs were intended to avoid. As the Second Circuit stated in *Aspinook Corporation* v. *Bright*, 165 F. 2d 294, 295 (2d Cir. 1947), "[T]here seems no occasion to call into play this extraordinary remedy and thus invite continued resort to it for various and sundry steps preliminary to trial which a litigant finds expensive or otherwise

[8] See cases cited n. 3, *supra*.

disturbing." The decisions of this Court, reviewed in the *Roche* case, fully justify this statement and the holdings of the Second Circuit and the Court below denying mandamus.

III. N.J.R.S. CUM. SUPP. 14:3-15, 14:3-17 ARE NOT APPLICABLE IN A FEDERAL COURT.

It is important to note, at this time, the two distinct questions underlying the issues in this aspect of this case. The first is whether a federal court, in a diversity case, must follow the procedure of requiring security to be posted in advance to which the corporation might be able to look for costs and attorneys' fees in the event that the individual defendants prevail in the action. The second is whether the federal court must award a corporation costs and expenses upon the failure of the plaintiffs to prove their cause of action. The questions are distinct for the reason that even if a plaintiff might ultimately be liable for fees and expenses by reason of the New Jersey statute, the New Jersey procedure of providing security from which those fees and expenses would be paid would not have to be adopted. Only if the Court should rule that the first question must be answered in the affirmative need it look to the second. If the Court rules, as it should, that the posting of security in advance is a procedural matter not binding on a federal court the second question need not now concern it.

Whether a bond is to be posted in advance is clearly a question which, even in diversity cases, is not controlled by state rules. Although we recognize that recent decisions of this Court, such as *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945) and *Angel* v. *Bullington*, 330 U. S. 183 (1947) command enforcement of state policies by federal courts, in the *York* case itself this Court pointed out that federal courts need not follow state law when what the state statute concerns is "merely the manner and the means by which a right to recover, as recognized by the State, is enforced * * *." 326 U. S. at 109. The time when petitioners should put up

moneys to which the respondent might eventually be entitled is certainly to be left to the discretion of the forum.

No one, to be sure, is so unsophisticated as to argue that state regulations of its processes of trials and appeals have no effect upon litigation. A state, by procedural regulation, can encourage or discourage general or particular types of litigation. It is not the doctrine of *Erie R. R.* v. *Tompkins*, 304 U. S. 64 (1938), however, that a federal court must enforce all the obstacles a state places in the way of enforcement of a substantive right.

> "State law cannot define the remedies which a federal court must give simply because a federal court in diversity jurisdiction is available as an alternative tribunal to the State's courts. Contrariwise, a federal court may afford an equitable remedy for a substantive right recognized by a State even though a State court cannot give it." *Guaranty Trust Co.* v. *York*, 326 U. S. 99, 106 (1945).

The policy underlying the *Erie R. R.* case is that the result on the merits should not be different. In all the cases since the *Erie* decision which have come before this Court, the federal court, had it not followed the state rule, might have reached a different result on the merits than that which would have been reached in the state court. Rules as to burden of proof, *Cities Service Oil Co.* v. *Dunlap*, 308 U. S. 208 (1939), conflict of laws, *Klaxon Co.* v. *Stentor Electric Mfg. Co.*, 313 U. S. 487 (1941), contributory negligence, *Palmer* v. *Hoffman*, 318 U. S. 109 (1943), statutes of limitation, *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945), and res judicata or jurisdiction, *Angel* v. *Bullington*, 330 U. S. 183 (1947), all might mean the difference between a judgment for the plaintiff and one for the defendant. But a rule as to security cannot possibly affect the outcome of a trial. See *Boyd* v. *Bell*, 64 F. Supp. 22 (S. D. N. Y. 1945).

Respondent refuses to separate the questions of security and the right to reimbursement for counsel fees and ex-

penses—though they will necessarily have to be decided at widely separated times. It contends that unless security is posted when the respondent moves for it, it can not secure reimbursement. No authority is advanced for this position; none exists. A reading of the New Jersey statute—on the issue of whether respondent can be entitled to such reimbursement—certainly does not preclude the awarding of such expenses in the judgment on the merits, if the court determines such expenses are due.

Thus far, we have spoken only of the New Jersey provisions relating to security; for they are, in our opinion the only ones at issue at this time in so far as their enforcement in a federal forum is concerned. But what is true of the security provisions is also true of the provisions of New Jersey law which authorize imposing upon a losing plaintiff liability for the defendants' expenses and attorneys' fees. These provisions similarly cannot affect the merits of the litigation.

It is true that in certain instances the federal courts have applied state statutes relating to attorneys' fees. See *Sioux County* v. *National Surety Co.*, 276 U. S. 238 (1928) and cases cited. But, as Judge Smith pointed out, these cases "are easily distinguishable from the present case." In all of them "the liability of the defendant for attorneys' fees and costs was a statutory liability assumed by the defendant under contract, and the right of the plaintiff to their recovery was absolute * * *." 7 F. R. D. at 356. No such contractual obligation can be spelled out here, especially since the suit itself was begun years before the statute was enacted.

Any remaining doubt as to the applicability of the New Jersey statute to the federal courts is completely dissipated by the provisions of Rule 23 of the Federal Rules of Civil Procedure. Chapter 431 is directed to the good faith of plaintiffs in bringing derivative actions. Congress and this Court in Rule 23 have already provided against bad faith and other abuses in derivative actions. Rule 23 insures adequate representation in stockholders' actions, safeguards against lack

of good faith by requiring a verified complaint, outlaws the purchase of stock in order to bring suit by requiring that the plaintiff be a shareholder at the time of the transaction of which he complains, prevents secret and unfair settlements by forbidding dismissal without the approval of the District Court and dismissal or compromise without notice. Thus, it has been affirmatively indicated that for the purpose of the Rules of Decisions Act, 28 U. S. C. § 1652 and *Erie R. R. v. Tompkins*, 304 U. S. 64 (1938), federal law, not state law, shall be governing. Indeed, Rule 23 is an "Act of Congress" within the meaning of the Rules of Decisions Act. See *Sibbach v. Wilson & Co.*, 312 U. S. 1, 15-16 (1940).

If state law were held governing, it would mean that Rule 23, in so far as it regulates stockholders' actions, is invalid, for the Rule would necessarily be dealing with matters of substance rather than procedure. See 3 Moore's Federal Practice (2d ed.) 3496. Yet the presumption of the validity of Rule 23 is very strong. As stated in *Sibbach v. Wilson & Co.*, *supra*, at 15-16:

> "The value of the reservation of the power to examine proposed rules, laws and regulations before they become effective is well understood by Congress. It is frequently, as here, employed to make sure that the action under the delegation squares with the Congressional purpose. Evidently the Congress felt the rule was within the ambit of the statute as no effort was made to eliminate it from the proposed body of rules * * *. That no adverse action was taken by Congress indicates, at least, that no transgression of legislative policy was found. We conclude that the rules under attack are within the authority granted."

The validity of Rule 23 has been many times sustained. See cases collected in 3 Moore's Federal Practice (2d ed.) 3496, n. 18; see also Hsen, *Monographs on Recent Developments and Trial and Appellate Practice* (1947) contained in Federal Rules of Civil Procedure With Approved Amendments (West Publishing Co. ed. 1947) 333.

Moreover, it cannot be argued that though Rule 23 governs such matters as whether a plaintiff must own stock at the time of injury, since it does not specifically refer to security and liability for expenses, the New Jersey statutes may nevertheless be applicable. It is clear that Rule 23 is a comprehensive scheme of regulating the abuses of stockholders' suits.[7] The field has been totally occupied by the federal government, and the states may not superimpose their own regulations. Or to put the matter differently, the federal government has characterized its rule as procedural and, therefore, conflicting or similar state statutes or rules must be similarly characterized for purposes of the *Erie* doctrine. As Judge Magruder said in *Sampson* v. *Channell*, 110 F. 2d 754, 756-57 (1st Cir., 1940), "There will be, inescapably, a twilight zone between the two categories [substance and procedure] where a rational classification could be made either way, and where Congress directly, or the Supreme Court under authority of the Act of June 19, 1934, 48 Stat. 1064, 28 U. S. C. A. §§ 723b, 723c, would have power to prescribe a so-called rule of procedure for the federal courts."

The corporation also suggests that Chapter 131 should have been applied in the District Court by virtue of Local Rule 15 of that Court.[8] Since Rule 23 of the Federal Rules of Civil Procedure occupies the field, Local Rule 15 is inoperative. Federal Rules Civil Procedure, Rule 83. Even if Rule 23 is not governing, it is not the function of local district court rules to resolve problems arising under the *Erie* doctrine. To permit each district court to choose for itself, would mean, for example, that in a state such as

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[7] That part of the Rule relating to ownership is derived from *Hawes* v. *Oakland*, 104 U. S. 450 (1882); see 1946 Note of the Advisory Committee to Rule 23. Other aspects of the Rule 23, contemplating "the compromise of stockholders' suits under proper supervision of the Court," incorporate a public policy. *Hinkelman* v. *General Motors Corp.*, 48 F. Supp. 504, 514 (S. D. N. Y. 1942).

[8] "In circumstances not provided for by the Federal Rules of Civil Procedure or by these rules, the procedure and practice of the Courts of the State of New Jersey shall govern."

New York which has more than one judicial district, each district would decide for itself whether to apply Section 61-b of the New York General Corporation Law.

IV. N.J.R.S. CUM. SUPP. 14:3-15 AND 14:3-17 VIOLATE THE FEDERAL CONSTITUTION.

The constitutional issues to which the remainder of the brief is devoted need be reached only if the Court rejects the petitioners' contentions heretofore made. There are, in fact, two sets of constitutional questions. In this section of the brief we shall discuss whether, apart from the retroactive effect of Chapter 131, the provisions of that chapter violate the federal Constitution. In the next section, we shall discuss the retroactive features of the legislation.

A. The Functions of the Derivative Action.

Stockholders' derivative actions have been firmly established as an integral part of Anglo-American jurisprudence for more than a century. *Hichens* v. *Congreve,* 4 Russ. 562, 38 Eng. Rep. 917 (Ch. 1828); *Dodge* v. *Woolsey,* 18 How. 331, 341-42 (1856). They have been an essential element in restraining the overreaching of corporate fiduciaries. The large amounts of corporate moneys received from derelict fiduciaries in actions of this type bear witness to the essential functions which these actions perform in protecting the investing public. Some of the recoveries in recent years, all involving publicly owned corporations, are compiled in Appendix "B".

Nor are the actual recoveries a full measure of the social benefits of stockholders' suits. As a deterrent to the greedy and a spur to the neglectful corporate fiduciary, they accomplish more by way of prophylaxis than redress.

> "Despite the numerous abuses which have developed in connection with such suits they have accomplished much policing the corporate system, especially in pro-

> tecting corporate ownership as against corporate management. They have educated corporate directors in the principles of fiduciary responsibility and undivided loyalty. * * * The measure of effectiveness of the stockholder's derivative suit cannot be taken by a computation of the money recovery in the litigated cases. The minatory effect of such actions has undoubtedly prevented diversion of large amounts from stockholders to managements and outsiders." Rifkind, *J.*, in *Brendle* v. *Smith*, 46 F. Supp. 522, 525-26 (S. D. N. Y. 1942).

The stockholders' suit is not only valuable, it is in fact, as Mr. Justice Shientag has stated, "the only civil remedy that stockholders have for breach of fiduciary duty on the part of those entrusted with the management and direction of their corporations." *Bayer* v. *Beran*, 49 N. Y. S. 2d 2, 4 (Sup. Ct. N. Y. Co. 1944). And it is not only the sole remedy for the stockholders but for the corporation itself. For a stockholders' suit lies only when a corporation, because it is controlled by the wrongdoers or for other reasons, fails and refuses to take appropriate action for its own protection. *United Copper Sec. Co.* v. *Amalgamated Copper Co.*, 244 U. S. 261, 263-64 (1917); Federal Rules Civil Procedure, Rule 23. The corporation thus has, by hypothesis, a valid cause of action against its faithless fiduciaries; it has the right to such judicial relief; but the right is only theoretical since those in control of the corporation will not enforce it and it must ultimately be barred by limitations. Unless a stockholder can intercede by derivative action, the corporation's right is nullified as though all right to relief were denied to the corporation in so many words.

This traditional remedy has always been available to the small as well as the large stockholder. As Mr. Chief Justice Hughes stated in *Ashwander* v. *Tennessee Valley Authority*, 297 U. S. 288, 318 (1936), "While their stockholdings are small, they have a real interest and there is no question that

the suit was brought in good faith. If otherwise entitled, they should not be denied the relief which would be accorded to one who owned more shares."

It is against this background that the constitutionality of Chapter 131, destroying the effectiveness of stockholders' suits, must be considered.

B. The History of Chapter 131.

Chapter 131 was "expressly patterned" after Section 61-b of the New York General Corporation Law, enacted a year before. Note (1947) 1 Rutgers U. L. Rev. 117; *Cohen* v. *Beneficial Industrial Loan Corporation*, 170 F. 2d 44, 50-51 (3d Cir., 1948). To the extent that it differs from the New York legislation, it is more severe. It is expressly retroactive, and it requires, for exemption from its provisions, a plaintiff to have securities having a market value in excess of $50,000 or at least five per cent "of the aggregate par value or stated value of all of the outstanding shares of such corporation's stock of every class." Section 61-b is not retroactive[9] and permits a plaintiff to be exempted who has securities having a market value in excess of $50,000 or at least five per cent "of the outstanding shares of any class of such corporation's stock or voting trust certificates * * *."

For all other purposes, however, and so far as they bear upon the case at bar, the New York and New Jersey statutes are identical, and the history of the former is the history of the latter.

That history is as relevant to this legislation as the legislative history was to the statute held unconstitutional in *United States* v. *Lovett*, 328 U. S. 303 (1946). The lack of deliberation and the pressures exerted have been excellently described by Zlinkoff, *The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Law* (1945) 54 Yale L. J. 352, and by Hornstein,

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[9] It was construed as prospective in operation in *Shielcrawt* v. *Moffett*, 294 N. Y. 180 (1945), in order to avoid the constitutional invalidities of retroactive legislation.

The Death Knell of Stockholders' Derivative Suits in New York (1944) 32 Calif. L. Rev. 123, 126. It is sufficient to say that the legislation was copied after recommendations made by a special committee of the Chamber of Commerce of the State of New York. Wood, Survey and Report Regarding Derivative Suits (1944). That report, made without public hearing and under private auspices, has been analyzed in both the Zlinkoff and Hornstein articles. At the risk of understatement it is of questionable accuracy and its lack of fairness is beyond dispute.

C. Equal Protection of the Laws.

That the legislation at issue was not a bona fide attempt to remedy the abuses of derivative suits is quickly revealed on the face of the legislation itself:

1. Chapter 131 requires security from small stockholders but not from large. A stockholder whose shares constitute less than five per cent of the corporation's stock and have a value of less than $50,000 is subject to the statute. But one holding more than five per cent or $50,000 worth of stock is exempt.

2. Chapter 131 imposes possible liability for attorneys' fees and expenses on small stockholders but not on large. In this respect too, a stockholder whose shares constitute less than five per cent of the corporation's stock and have a value of less than $50,000 is subject to the statute. But one holding more than five per cent or $50,000 worth of stock is exempt. *Isensee* v. *Long Island Motion Picture Co.*, 184 Misc. 625, 54 N. Y. S. 2d 556 (Sup. Ct. Queens Co. 1945).

No basis in law or in fact is available to support this classification and none has ever been suggested. The Wood report did not contain any facts justifying a distinction between stockholders owning less than five per cent or less than $50,000 and stockholders owning greater amounts. The report merely assumed that stockholders who had less than five per cent or $50,000 worth of securities in "publicly held corporations" had "stockholdings * * * too small to indicate legitimate personal interest in the outcome."

But neither in the Wood report nor elsewhere are there any statistics or factual data or, indeed, philosophic speculations which would demonstrate that stockholders holding less than five per cent or $50,000 in value have no legitimate interest in their corporation or in the outcome of a derivative suit on behalf of their corporation.

Indeed, experience is exactly to the contrary. The overwhelming majority of all shareholders in publicly owned corporations have small holdings. Berle and Means, The Modern Corporation and Private Property (1932) 47-48; T. N. E. C., Monograph 29, The Distribution of Ownership in the 200 Largest Non-Financial Corporations (1940) 69 ff. 623 ff. The fraud or dereliction of those in control injures the small shareholder proportionally as much as the large shareholder is injured. The classification of the statute, if based upon financial interest, is arbitrary.

Nor is the 5%—$50,000 line justified by any facts demonstrating that strike suits are brought only by stockholders owning lesser amounts. As one commentator stated, "There is * * * no evidentiary support for an assumption that derivative suits brought by those holding $50,000 worth of stock or 5% thereof are more meritorious or brought in better faith than those brought by stockholders owning lesser amounts of shares or that more suits of this character are brought in bad faith by small stockholders than by larger stockholders." Zlinkoff, *The American Investor and the Constitutionality of Section 61-b of the New York Corporation Law* (1945) 54 Yale L. J. 352, 386. Or in the words of another writer "a legislative holding that a small shareholder's suit is presumptively a 'strike' suit not only finds no factual basis but constitutes a type of class legislation that is arbitrary, antisocial and Hamiltonian in its economic shortsightedness." Jackson, *Reorganization of the Corporate Concept and the Effect of Section 61-b of the New York General Corporation Law* (1944) 45 Corp. Reorg. & Amer. Bank. Rev. 323, 340.

In short, Chapter 131 is not motivated either by a legitimate differentiation between the stock of a large and small

stockholder nor by the abuses of stockholders' suits. One might understand requiring the small stockholder alone to give security; one cannot understand subjecting the small stockholder alone to possible liability for attorneys' fees and expenses. One could also understand imposing liability for attorneys' fees and expenses on all those who brought suits without good cause being shown. See *Lowe v. Kansas*, 163 U. S. 81 (1896); Section 11(e) of the Securities Act of 1933 as amended, 11 U. S. C. § 77(k)(e). But one cannot understand imposing possible liability only on small stockholders.

In truth, the statute at bar proceeds on an assumption that only the wealthy or the large stockholder, who, if he is not identical with management, is often allied with it, can be interested in his corporation's affairs. The wealthy or large shareholder may bring stockholder suits, legitimate or otherwise, without putting up security and without being subjected to possible liability. As such it violates the canons of equal protection long stated by this Court. What was said in *Gulf, C. & S. F. R. Co. v. Ellis*, 165 U. S. 150, 155 (1897), has the same pertinence today as when it was written:

> "The State may not say all white men shall be subjected to the payment of the attorneys' fees of parties successfully suing them, and all black men not. It may not say that all men beyond a certain age shall be alone thus subjected, *or all men possessed of a certain wealth*. These are distinctions which do not furnish any proper basis for the attempted classification." (Emphasis added.)

Never once in the history of this Court has a classification based as is this on wealth alone been sustained. In all the cases where state statutes imposing attorneys' fees as part of a recovery have been sustained, as against a claim of equal protection, none is to be found where a classification was based on the total or partial wealth of either of the parties. *Atchison, T. & S. F. R. Co. v. Matthews*, 174 U. S.

96 (1899); *Fidelity Mutual Life Ass'n v. Mettler*, 185 U. S. 308 (1902); *Farmers & M. Ins. Co. v. Dobney*, 189 U. S. 301 (1903); *Seaboard Air Line R. Co. v. Seegers*, 207 U. S. 73 (1907); *Missouri, K. & T. R. Co. v. Cade*, 233 U. S. 642 (1914); *Missouri K. & T. R. Co. v. Harris*, 234 U. S. 412 (1914); *Missouri Pac. R. Co. v. Larabee*, 234 U. S. 459 (1914); *Chicago & N. W. R. Co. v. Nye Schneider Fowler Co.*, 260 U. S. 35 (1922); *Sioux County v. National Surety Co.*, 276 U. S. 238 (1928); *Doherty v. Rogers*, 281 U. S. 362 (1930); *Life & Casualty Ins. Co. v. McCray*, 291 U. S. 566 (1934). Indeed, in the one instance where the classification came near to being based upon wealth, this Court unanimously held unconstitutional a state statute awarding attorneys' fees. *Atchison, T. & S. F. R. Co. v. Vosburg*, 238 U. S. 56 (1915).

D: Due Process of Law.

N. J. R. S. Cum. Supp. 14:3-15 and 14:3-17 violate both the procedural and substantive aspects of the due process clause of the Fourteenth Amendment. Procedurally, these provisions unreasonably qualify—and in effect deny—access by certain plaintiffs to the courts for legal wrongs. Substantively, the legislation violates the due process clause by imposing arbitrary impediments, without reasonable relation to any existing abuses.

1. *Procedural Due Process:* The State of New Jersey has not attempted in terms to exonerate corporate directors and officers from liability for their defalcations involving property of corporations they control. Nor in terms has it forbidden stockholders holding less than five per cent of the outstanding stocks or stocks worth $50,000 or less from bringing suit on behalf of the corporation to remedy such defalcations. But the provisions of New Jersey law, here involved, accomplish these ends as effectively as if such legislation had been passed. No plaintiff, unless he have tremendous resources, can afford to give security in the amount which the statute indicates. Nor certainly will he

litigate difficult questions of corporate law when, in the event he loses, he must pay expenses and counsel fees of the corporation and the individual defendants. For apart from the expenses other than counsel fees, "It is not unusual nor would it be unreasonable for defendants in such actions to retain distinguished counsel. Stockholders' actions are ordinarily directed against several defendants, each of them entitled to counsel of his own choice. The anticipated aggregate charge of several prominent law firms for services in a protracted and intricate litigation are bound to be formidable." *Citron* v. *Mangel Stores Corp.*, 50 N. Y. S. 2d 416, 419 (Sup. Ct. N. Y. Co. 1944).

The effect of Chapter 131 is to place upon the plaintiff the possibility of an enormous liability when there is no possibility of a commensurate reward. The plaintiff can recover nothing for himself; yet if he loses, he may have to pay enormous costs. This is not equal treatment; it is not fair treatment. It gives the opportunity to erect a barrier against suit to the very persons accused of fiduciary delinquency, and it places a premium on dilatory tactics by imposing on plaintiffs the expense of such tactics in the event the case is lost. In the language of Mr. Justice Cardozo it creates "an unfair barrier against the endeavor of an honest litigant to obtain the judgment of a court. In that event, the Constitution intervenes and keeps the court room open." *Life & Casualty Ins. Co.* v. *McCray*, 291 U. S. 566, 574-75 (1934). Constitutional rights may be nullified quite as readily and completely by procedural obstructions to their effective assertions and maintenances as by outright substantive denial. In order to be constitutional, a penalty or stimulus "in the form of attorneys' fees" "must be moderate and reasonably sufficient to accomplish their legitimate object * * *. [T]he imposition of penalties or conditions that are plainly arbitrary and oppressive and 'violate the rudiments of fair play' insisted on in the Fourteenth Amendment, will be held to infringe it." *Chicago & N. W. R. Co.* v. *Nye Schneider Fowler Co.*, 260 U. S. 35, 44 (1922).

Respondent seeks security in the sum of $125,000. No comparable sum was involved in any of the attorneys fees cases decided by the Supreme Court. A statutory fine of $5,000 was stricken down in *Ex parte Young*, 209 U. S. 123 (1908), as foreclosing access to the court: Liquidated damages of $500 were held unconstitutional for the same reason in *Missouri Pac. R. Co.* v. *Tucker*, 230 U. S. 340 (1913). The $125,000 security, or any sizeable portion thereof is so clearly and unmistakably prohibitive as to make further analysis of the authorities superfluous.

For the above reasons, this Court cannot avoid a determination of the constitutionality of this legislation as against the claim that it violates procedural due process, though no actual security has been required of the plaintiffs and though no payment of attorneys' fees or expenses has been demanded.[10] It is settled doctrine ever since *Ex parte Young*, 209 U. S. 123 (1908) that the deterrents to judicial action may be so great as themselves to be unconstitutional. In such cases it is not necessary to subject oneself to the penalizing deterrent. *Ex parte Young, supra; Oklahoma Operating Co.* v. *Love*, 252 U. S. 331 (1920); *Wadley Southern R. Co.* v. *Georgia*, 235 U. S. 601 (1915); *Southwestern Tel. Co.* v. *Danaher*, 238 U. S. 482 (1915); *Missouri Pac. R. Co.* v. *Tucker*, 230 U. S. 340 (1913). See *Petroleum Exploration, Inc.* v. *Public Service Commission*, 304 U. S. 209, 218-219 (1938). Just how great the deterrent is appears from the fact that the defendant corporation requested security of not less than $125,000 and from the experience under Section 61-b where the amounts of security required have ranged from $5,000 to at least $75,000. Zlinkoff, *The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Law* (1945) 54 Yale L. J. 352; *Tichner* v. *Andrews*, C. C. H. N. Y. Corp L. Rep ¶10,206. The Wood Report itself shows that the individual defendants' expenses and

[10] In *Lapchak v. Baker*, 298 N. Y. 89 (1948), as the opinion discloses, the Court of Appeals was limited in its jurisdiction upon appeal by the New York Constitution.

counsel fees have frequently exceeded $100,000. Wood, Survey and Report Regarding Derivative Suits (1944) 8. If a plaintiff must post security or pay attorneys' fees and expenses before testing the constitutionality of this legislation, no test will ever be forthcoming. For no plaintiff, who is affected by the statute, will bring a stockholders' action faced by the possibility of such tremendous liability.

2. *Substantive Due Process*: So far as substantive aspect of the due process clause is concerned, the total unreasonableness of the legislation at issue is best demonstrated by the discrepancy between the evils to be cured and the "remedies" adopted by the statute. The principal wrongs that may arise in stockholders' suits are (1) the bringing of a suit without any reasonable basis in order to secure a payment to prevent harassment; (2) the private settlement of suits either to avoid such harassment or to buy off the revelation of the wrongdoing that the action would bring into the open; (3) the large costs that a corporate defendant must incur to defend groundless suits; (4) the large counsel fees awarded; (5) duplicate suits; (6) champerty and maintenance.

The statute, however, makes no distinction between groundless suits and suits based on reasonable grounds; it does not prevent the secret settlements by means of which meritorious suits are prevented from being carried to a successful conclusion or non-meritorious suits are simply bought off by the defendants; it does not provide for the reimbursements of large costs incurred in the defense of a groundless suit unless the plaintiff owns less than a specified amount of stock—a distinction already shown to be arbitary; it says nothing about excessive plaintiff's attorneys' fees; it does not prevent more than one suit based on the same cause of action; it does not regulate the conduct of attorneys or the attorney-client relationship. It is not even the purpose of the statute to require a minimum amount of stock to be represented in the prosecution of the action. The New York decisions reveal that the joinder, after an action has been commenced, by

plaintiffs owning at least the minimum amount of stock required by the statute does not obviate the necessity for the security nor eliminate the potential liability for attorneys fees and expenses. *Baker* v. *MacFadden Publications, Inc.*, 270 App. Div. 440, 59 N. Y. S. 2d 841 (1st Dept., 1946); *Noel Associates, Inc* v. *Merrill*, 184 Misc. 646, 53 N. Y. S. 2d 143, 153 (Sup. Ct. N. Y. Co. 1944); *Weinstein* v. *Behr*, 68 N. Y. S. 2d 199 (Sup. Ct. N. Y. Co. 1947).

The distinction between the alleged bases for the statute and the unstated real premises is further ascertained by the difference between the legislation as enacted and the remedies available to the legislature if its purpose were what it pretends to be. The New Jersey legislature could have subjected all plaintiffs in stockholders' actions to liability for expenses upon a judicial finding of lack of good faith, it could have outlawed secret settlements either by requiring notice to all shareholders or by insisting upon judicial approval. These remedies it could have chosen, in addition to more radical improvements such as granting to an administrative agency powers of scrutiny over corporate transactions and of enforcement of private rights. That it legislated as it did, despite the multiple choices open to it, indicates that the statute was intended, not as a correction of abuses but as a "death knell" of the small stockholders' only remedy for corporate wrongs, an objective which it could not openly seek or achieve without running afoul of the Fourteenth Amendment's due process clause.

It is unnecessary to make nice distinctions as to whether Chapter 131 has taken away property belonging to the stockholder or property belonging to the corporation in whose right he sues. Sufficient is it that the stockholder, owning less than five per cent or $50,000, has been deprived of his only effective remedy against corporate abuse. Although we frankly admit that abuses of the derivative action exist, in the words of Mr. Justice Rosenman, "the stockholders' suit is, at present, the only practical way of permitting the small stockholder to question controlling stockholders and directors" [quoted in *Shielcraft* v. *Moffet*, 49 N. Y. S. 2d 64, 71

(Sup. Ct. N. Y. Co. 1944). Indeed, this Court, as long ago as 1882, recognized that

> "The exercise of this power in protecting the stockholder against the frauds of the governing body of directors or trustees, and in preventing their exercise, in the name of the corporation, of powers which are outside of their charters or articles of association, has been frequent, and is most beneficial and is undisputed." *Hawes v. Oakland*, 104 U. S. 450, 452 (1882).

We contend that the state may not destroy this sole remedy[11] without providing some substitute. It is unnecessary to explore the uncharted areas of constitutional law as to the power of a state to abolish particular rights of action, such as trespass or slander. See *Honfgarn* v. *Mark*, 274 N. Y. 22 (1937). For whatever the power of the state may be to modify or repeal remedies and whatever its power to abolish rights, "recognized by the common law, to attain a permissible legislative object" *Silver* v. *Silver*, 280 U. S. 117, 122 (1929), certainly a state may not deny to some the power to enforce a right it permits others to enforce.

On two grounds, therefore, this statute is violative of substantive due process. It is completely unrelated to the abuses at hand. It destroys for some, but not for all, the only remedy to enforce rights which the laws of New Jersey, and indeed the statute itself, recognizes.

E. Full Faith and Credit.

In so far as N. J. R. S. Cum. Supp. 14:3-15 and 15:3-17 apply to actions by residents of other states on behalf of foreign corporations, they violate the full faith and credit clause of the federal Constitution and are an attempt by the State of New Jersey to affect relationships in which it has

[11] Even if the visitatorial power of the State or the processes of the criminal law were effective checks upon corporate abuses, which they cannot be, they would be unavailing to return to a corporation money taken from it.

no interest and over which it has no control. They create the very barriers which "it has been the whole course of our law to break down * * * against calling corporations to account in all states where they may do wrong in doing business." Mr. Justice Reed dissenting in *Koster* v. *Lumbermen's Mutual Casualty Co.*, 330 U. S. 518, 538 (1947).

Since Beneficial is a Delaware corporation, and the question at issue is one of the rights of stockholders against the corporation and of the corporation against stockholders, Delaware law must govern. *Selig* v. *Hamilton*, 234 U. S. 652 (1914); *Converse* v. *Hamilton*, 224 U. S. 243 (1912); *Canada Southern R. R.* v. *Gebhard*, 109 U. S. 527 (1883); *Upson* v. *Otis*, 155 F. 2d 606 (2d Cir., 1947); Restatement, Conflict of Laws (1934) § 183; 2 Rabel, The Conflict of Laws (1947) 3.

Under that law a stockholder may bring a derivative suit on behalf of his corporation without putting up security and being subjected to liability for the defendant and attorneys' fees. He must, however, have been a stockholder at the time of the transaction complained of. Delaware Corporation Law, § 51-a.

For purposes of the full faith and credit clause, it makes no difference that Delaware law on the subject has not been reduced to statutory form.[12] It is elementary, of course, that

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[12] In Delaware, the law permitting stockholders' derivative suits is of decisional origin. Nevertheless it might be said that, for purposes of the full faith and credit clause, the common law of Delaware is of statutory character, since it rests upon the reception clause of Delaware's Constitution. See *Tennessee Coal, I. & R. Co.* v. *George*, 233 U. S. 354, 361 (1914). Art. I, § 25, of the Delaware Constitution of 1776 provided:

> "The Common Law of England as well as so much of the statute law as have been heretofore adopted in practice in this State, shall remain in force, unless they shall be altered by a future law of the Legislature * * *."

This provision was, in effect, continued by Art. XVI, § 18, of the Delaware Constitution of 1897, now in force, which provides:

> "All the Laws of this State existing at the time of this Constitution shall take effect, and not inconsistent with it shall remain in force, except so far as they shall be affected by future laws."

See *Wilmington Housing Authority* v. *Fidelity & Deposit Co. of Maryland*, 47 A. 2d 524, 530 (Sup. Ct. Del., 1946, dissenting opinion).

the statutes of a foreign state are its "public acts" and, as such, are entitled to full faith and credit. *Modern Woodmen v. Mixer*, 267 U. S. 544, 551 (1925); *Bradford Electric Light Co. v. Clapper*, 286 U. S. 145, 154-55 (1932); *Broderick v. Rosner*, 294 U. S. 629, 644 (1935). But the same is true of a foreign state's decisional law, as this Court has recognized: "the faith and credit * * * to which local common and statutory law is entitled under the Constitution." *Magnolia Petroleum Co. v. Hunt*, 320 U. S. 430, 436 (1943). For "the law of a state is embodied as well in its common-law rules as in its statutes". *Id.* at 445; Jackson, *Full Faith and Credit—The Lawyer's Clause of the Constitution* (1945) 45 Col. L. Rev. 1, 12; Cheatham, *Res Judicata and the Full Faith and Credit Clause* (1944) 44 Col. L. Rev. 330, 333. Any question about this has been resolved in *Aetna Life Ins. Co. v. Dunken*, 266 U. S. 389, 393, 399 (1924); where the full faith and credit clause was held to require the subordination of the *lex fori* to the unwritten laws of the state where the contract in suit had been made, and in *Order of United Commercial Travelers v. Wolfe*, 331 U. S. 586 (1947), where a statute of the forum was required to yield to the unwritten laws of the state where the corporate defendant was organized.

Under the full faith and credit clause, New Jersey cannot constitutionally enforce Chapter 131 in this case, if Delaware is "competent to legislate" concerning the subject matter and if "of the conflicting interests involved those of the foreign state are superior to those of the forum". *State Farm Mutual Automobile Ins. Co. v. Duel*, 324 U. S. 154, 160 (1945); *Pink v. A. A. A. Highway Express Co., Inc.*, 314 U. S. 201, 209-11 (1941); *Pacific Employers Ins. Co. v. Industrial Accident Commission*, 306 U. S. 493, 501 (1939). Conflicting state policies must be reconciled, "not by giving automatic effect to the full faith and credit clause, compelling the courts of each state to subordinate its own statutes to those of the other, but by appraising the governmental interests of each jurisdiction, and turning the scale of decision according to their weight". *Alaska Packers Assn. v. Industrial Accident*

Commission, 294 U. S. 532, 547 (1935). Similar rules flow from the due process clause. *Home Ins. Co.* v. *Dick*, 281 U. S. 397 (1930); *Hartford A. & I. Co.* v. *Delta & Pine Land Co.*, 292 U. S. 143 (1934).

The subject matter here involved is a corporation's right to reimbursement of its litigation expenses by an unsuccessful stockholder-plaintiff. Which state, New Jersey or Delaware, is "competent to legislate" thereon? Which state, New Jersey or Delaware, has governmental interests therein "superior" to those of the other?

We submit that Delaware has the superior interest. The legal incidents of membership in a corporation are governed by the laws of the state in which the corporation is organized. *Modern Woodmen* v. *Mixer*, 267 U. S. 544, 551 (1925); *Broderick* v. *Rosner*, 294 U. S. 629, 643-44 (1935). It is the state of incorporation which determines, as it must and should, the legal relationship between the stockholder, the officers, the directors, and the corporation itself. If this were not the case, any state in which a corporation did business could modify the charter. See *Canada Southern R. R.* v. *Gebhard*, 109 U. S. 527 (1883).

If statutes such as Chapter 131 are substantive for purposes of *Erie R. R.* v. *Tompkins*, the state should not be permitted to impose upon the federal courts irrational conflict of laws rules. *Klaxon Co.* v. *Stentor Electric Manufacturing Co.*, 313 U. S. 487, 496 (1941), was careful to note that a state's conflict of laws policies must be "within the limits permitted by the Constitution." New Jersey has departed from those limits by denying stockholders of a Delaware corporation the rights given by Delaware law and by imposing upon them penalties and liabilities not imposed by Delaware law. The analogy to *Broderick* v. *Rosner*, 294 U. S. 629 (1935), is a very close one. In that case, New Jersey attempted by statute to bar an action, brought by the Superintendent of Banks of New York, against New Jersey residents, who were stockholders in the Bank of the United States, to recover assessments levied by him in accordance with the law of New York, where the banking corporation had been organized.

Mr. Justice Brandeis for the Court held that the New Jersey law could not govern. As he stated, "Obviously recognition could not be accorded to a local policy of New Jersey, if there really were one; of enabling all residents of the State to escape from the performance of a voluntarily assumed statutory obligation, consistent with morality * * *." 294 U. S. at 644.

V. THE RETROACTIVE APPLICATION OF N.J.R.S. CUM. SUPP. 14:3-15, IN ACCORDANCE WITH THE TERMS OF N.J.R.S. CUM. SUPP. 14:3-17, VIOLATES THE FEDERAL CONSTITUTION.

The retroactive application of the provisions of Chapter 131, here at issue, since they would effectively destroy the sole remedy of the stockholder to rectify defalcations of officers and directors, violates the due process clause of the Fourteenth Amendment and the impairment of contract clause of the federal Constitution.

As a result of the serious constitutional questions which would otherwise have arisen, the New York courts construed Section 61-b as being prospective in operation only. *Shielcraft* v. *Moffett*, 294 N. Y. 180 (1945). See the dissenting opinion of Justice Callahan in *Shielcraft* v. *Moffett*, 268 App. Div. 352, 51 N. Y. S. 2d 188 (1st Dept., 1944). Unfortunately, these same questions cannot be so avoided here. The New Jersey statute was made expressly retroactive and thus although not enacted until 1945, affects this suit which was commenced in 1943.

It has frequently been held by this Court that the Fourteenth Amendment, although it does not protect any particular form of remedy, does guarantee the preservation of a "substantive right to redress" a pre-existing cause of action "by some effective procedure." *Gibbes* v. *Zimmerman*, 290 U. S. 326, 332 (1933); *Ettor* v. *Tacoma*, 228 U. S. 148 (1913). But "statutes which take away every remedy for past wrongs, as distinguished from statutes which merely change the remedy, are condemned as unconstitutional," Cardozo, *J.* in

Jacobus v. *Colgate*, 217 N. Y. 235, 241 (1916). *Forbes Pioneer Boat Line* v. *Board of Commissioners*, 258 U. S. 338, 339, 340 (1922) is wholly applicable to this case.

> "Stripped of conciliatory phrases the question is whether a state legislature can take away from a private party a right to recover money that is due when the act is passed."
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> * * * * * *
>
> "Defendant owed the plaintiff a definite sum of money that it had extorted from the plaintiff without right. It is hard to find any ground for saying that the promise of the law that the public force shall be at the plaintiff's disposal is less absolute than it is when the claim is for goods sold."

Mr. Justice Holmes' words would be governing at bar even if this litigation had not been actually instituted two years prior to the enactment of the legislation in question. But the fact that New Jersey is attempting to apply its statutes not only to pre-existing causes of action but to pre-existing suits on such causes of action appears to make this case unique.[13] See Stimson, *Retroactive Application of Law—A Problem in Constitutional Law* (1939) 38 Mich. L. Rev. 39, Smead, *The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence* (1936) 20 Minn. L. Rev. 775. In no case which we have found has a state been permitted effectively to deprive a party of a private cause of action upon which suit had already been brought.

What is true of the due process clause is also true of the contract clause. Article 1, Section 10 also prohibits the

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[13] The two Supreme Court cases cited by the Court of Appeals are not relevant. *Western Union Telegraph Co.* v. *Louisville & Nashville R. Co.*, 258 U. S. 13 (1922), held that the State could withdraw a right of condemnation it had conferred on telegraph companies. The statute was held applicable to a pending suit on the express ground that it involved "an exertion of power in the public interest of which the companies are the instruments or agents." *Blount* v. *Windley*, 95 U. S. 173 (1877), held constitutional the application of a North Carolina set-off statute to a judgment already obtained. Thereby multiplicity of suits was avoided, and no substantive rights were diminished.

application of Chapter 131 to a pending suit. The petitioner's relationship with the respondent was, of course, contractual. Although not expressly part of that contract, *Myer* v. *Myer*, 271 App. Div. 465, 66 N. Y. S. 2d 83 (1st Dept., 1946), aff'd 296 N. Y. 979 (1947), implicit in it was the unqualified right given them by Delaware law to bring a derivative action; for "the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms." *Van Hoffman* v. *Quincy*, 4 Wall. 535, 550 (1867), quoted in *Wood* v. *Lovett*, 313 U. S. 363, 370 (1941). The law so incorporated may be non-statutory as well as statutory. *Bronson* v. *Kenzie*, 1 How. 311, 319 (1843).

The plaintiffs' contract with their corporation has been impaired as surely as were the creditors' rights in *Coombes* v. *Getz*, 285 U. S. 434 (1932) and *Hathorn* v. *Calef*, 2 Wall. 10 (1865).

CONCLUSION.

The Court of Appeals for the Third Circuit erred in taking jurisdiction of the appeal from the District Court's interlocutory order; the issues could be raised neither by direct appeal nor by mandamus. It was also in error in holding that Chapter 131 was applicable in the federal courts and in sustaining the constitutionality of this New Jersey legislation. Thus, for the reasons heretofore stated, the Court should reverse the judgment of the Court of Appeals in No. 442 and affirm the judgment in No. 512.

Respectfully submitted,

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APPENDIX A.

Statutes Involved.

Chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17) provides as follows:

> "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive.
>
> * * * * *

"This act shall take effect immediately and shall apply to all such actions, suits or proceedings now pending in which no final judgment has been entered, and to all future actions, suits and proceedings."

28 U. S. C. § 1291 Provides as follows:

"The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the District Court for the Territory of Alaska, the United States District Court for the District of the Canal Zone, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court."

28 U. S. C. § 1651 (a) provides as follows:

"The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions agreeable to the usages and principles of law."

28 U. S. C. § 1652 provides as follows:

"The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

Rule 23 of the Federal Rules of Civil Procedure provide as follows:

"(a) Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is

(1) joint, or common, or secondary in the sense that the owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce. * * *

"(b) Secondary Action by Shareholders. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because that association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.

"(c) Dismissal or Compromise. A close action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. * * *"

APPENDIX B.

SCHEDULE OF RECOVERIES OF MORE THAN $25,000 IN STOCKHOLDERS' DERIVATIVE ACTIONS INVOLVING PUBLICLY OWNED CORPORATIONS.*

Price v. *Crede Petroleum Corp.*, N. Y. L. J. 5/13/47 p. 1878, col. 3	$23,000,000
Perrine v. *Pennroad Corp.*, 43 A. 2d 479 (Del. Ch., 1945)	15,000,000
Johnson v. *Western Union Telegraph Co.* (Gold & Stock Tele Co.), 185 Misc. 728, 53 N. Y. S. 2d 867 (S. Ct. 1945) (est.)	8,000,000
Mann v. *Hearst*, Superior Ct., Los Angeles Co., Cal. Index No. 432229 (Judg. 11/10/41)	5,022,258
Winkelman v. *Gen'l Motors Corp.*, U. S. D. C., S. D. N. Y. 84221/1936	4,500,000
Shanik v. *Empire Power Corp.*, Index No. 8634/1945	4,261,684
Rosenak v. *Lucas* (Diamond Match Co.), Index No. 27467/1946 (est.)	4,250,000
Bookbinder v. *Chase Nat'l Bank*, Index No. 42665/1933	2,500,000
Posen v. *Cowdin* (Universal Pictures Corp.), Index No. 33135/1940, N. Y. L. J. 6/3/43, p. 2164, col. 6	2,000,000
Loreman v. *Loft, Inc.*, Index No. 3392/1940	1,968,487
Gallin v. *Nat'l City Bank*, Index No. 8297/1933	1,847,943

* The schedule, not intended to be complete, has been compiled largely from data set forth in Appendix D of the *Survey and Report Regarding Stockholders' Derivative Suits* (1944), prepared by the Chamber of Commerce of the State of New York; Hornstein, *Problems of Procedure in Stockholders' Derivative Suits* (1942) 42 Col. L. Rev. 574, 587; and Hornstein, *New Aspects of Stockholders' Derivative Suits* (1947) 47 Col. L. Rev. 1, 16-17.

Except where otherwise indicated index numbers are those of the New York County Clerk.

Heller v. *Boylan* (Amer. Tob. Co.), Index No. 11877/1939	1,809,935
Bysheim v. *Miranda* (Brewster Aero. Corp.), 45 N. Y. S. 2d 473 (S. Ct., 1943)	1,800,000
Donovan v. *Atlas Corp.*, Index No. 34032/1934	1,500,000
Weiss v. *Gen'l Inv. Co.*, Index No. 31607/1937	1,375,000
Phillips v. *Cities Service Co.*, U. S. D. C., S. D. N. Y., 77-6/1933	1,250,000
Cwerdinski v. *Bent* (Bethlehem Steel Corp.), Index No. 30271/1937	1,105,821
Druckerman v. *Harbord* (Radio Corp of America), Index No. 31307/1938	1,000,000
Kalmanash v. *Smith* (Certainteed Products Corp.), N. Y. L. J. 5/13/44, p. 1869, col 6 (est.)	1,000,000
Murphy v. *North Amer. L. & P. Co.*, U. S. D. C., S. D. N. Y., 85-335/1937 (est.)	900,000
Litwin v. *Allen* (Guar. Trust Co.), Index No. 2418/1938	750,000
Diamond v. *Davis* (U. S. Rubber Co.), 62 N. Y. S. 2d 175 (S. Ct., 1945) (est.)	750,000
U. S. Lines Inc. v. *U. S. Lines Co.*, U. S. D. C., S. D. N. Y. 57195/1934	750,000
Fleishhacker v. *Blum* (Anglo-California Bank of San Francisco), 109 F. 2d 543 (9th Cir., 1940)	736,485
Benedict v. *Seagrave* (Insuranshares Corp.), Index No. 45607/1933	723,500
Bing v. *Consolidated Oil Corp.*, Index No. 34356/1936	675,000

Neuberger v. *Barrett* (Union Carbide & Carbon Corp.), 180 Misc. 222, 39 N. Y. S. 2d 575 (S. Ct., 1942)	(est.)	653,000
Andrews v. *Hupp Motor Co.*, Index No. 20878/1934		612,500
Cohen v. *Macfadden* (Macfadden Publications, Inc.), Index No. 13724/1940		550,000
Epstein v. *Schenck* (Loew's, Inc.), Index No. 3033/1938		527,802
Weiss v. *Coe* (Brooklyn Union Gas Co.), Index No. 2204/1941		476,549
Chelrob, Inc. v. *Barrett* (Queensboro Gas & Elec. Co.), 185 Misc. 305, 56 N. Y. S. 2d 628 (S. Ct., 1945)		470,854
Steinberg v. *Mitchell* (Electric Bond & Share Co.), Index No. 26739/1932		400,000
Gans v. *Hearst*, Index No. 15968/1938		400,000
Wilkay Corp. v. *Goldman-Sachs Trading Corp.*, Index No. 3363/1932		385,000
Blank v. *Sams* (J. C. Penney Co.), Index No. 20382/1944		330,000
Adams v. *Lang* (Crocker Wheeler Corp.), Index No. 29185/1936		325,000
Streicher v. *Utility & Ind. Corp.*, U. S. D. C., S. D. N. Y. 87126/1938		275,000
Garsson v. *Nat'l Rubber Mach. Co.*, Index No. 25826/1939		245,000
Sarasohn v. *Andrew Jergens Co.*, 45 N. Y. S. 2d 888 (S. Ct., 1943)	(est.)	210,000
Shielcrawt v. *Moffett* (Corn Products Ref. Co.), Index No. 14134/1940		204,341
Gray v. *Burco, Inc.*, Index No. 14912/1938		200,000

Roth v. *Abrons* (Gen. Realty & Ut. Corp.), Index No. 94/1942	160,000
Becber v. *Empire Power Co.*, Index No. 25012/1937	150,000
Naitove v. *Morrow* (Hecker Products Corp), Index No. 8843/1939	130,000
Said v. *Eitington Schild Co., Inc.*, Index no. 25484/1935	100,000
Baumgold v. *Bailey* (Title Guar. & Trust Co.), Kings Co. Clerk's Index No. 148/1942	80,000.
Smith v. *Loft, Inc.* (Happiness Candy Stores, Inc.), Index No. 20305/1941	75,000
Lesire Corp. v. *Amer. Com'l. Alcohol Co.*, Index No. 27589/1935	70,000
Jules Mar. Inc. v. *Com'l. Credit Co.*, Index No. 20742/1941	60,000
Caulfield v. *Amer. Founders Co.*, Index No. 45610/1933	60,000
Hagenbusch v. *Am. Ber. Co.*, Index No. 14931/1942	50,000
Harris v. *Fenner* (Croft Brewing Co.), Index No. 4751/1938	50,000
May v. *Interstate Hosiery Mills, Inc.*, Index No. 27887/1938	34,000
Mason v. *Richardson* (Columbia Broadcasting Co.), Index No. 1534/1941	32,500
Berger v. *Allen* (Empire Trust Co.), Kings Co. Clerk's Index No. 7205/1942	25,000
Martin v. *United Standard Oil Fund of America*, U. S. D. C., S. D. N. Y. 86-175/1937	25,000

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Supreme Court of the United States

OCTOBER TERM, 1948.

No. 442.

HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenor,
Petitioners,

against

BENEFICIAL INDUSTRIAL LOAN CORPORATION,
Respondent,

and

O. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAUL A. SEIBOLD, Individually,
Defendants.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI.

Opinions Below.

The opinion of the Court of Appeals (R. 40-61) is reported in 170 F. 2d 44. The opinion of the District Court (R. 29-38) is reported in 7 F. R. D. 352.

Jurisdiction.

The petitioners have invoked the jurisdiction of this Court under 28 U. S. C. §§ 1254(1) and 2101(c).

Statutes Involved.

Chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17) provides as follows:

> "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive.
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> "This act * * * shall take effect immediately and shall apply to all such actions, suits or proceedings

now pending in which no final judgment has been entered, and to all future actions, suits and proceedings."

28 U. S. C. § 1652 provides as follows:

> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

Statement.

The decree of the Court of Appeals here sought to be reviewed decided a controversy between the respondent corporation and the petitioners, its stockholders, involving the enforcement by respondent against petitioners of its right to be reimbursed by the petitioners for certain expenses and counsel fees in a stockholders' derivative suit. The main action was instituted in the right of the respondent corporation on August 9, 1943 by Sol Cohen, as holder of 100 shares of the outstanding 2,000,000 shares of respondent's common stock, against certain directors and officers of the respondent corporation and others.

Issue has not yet been joined in such action. A summary of the proceedings in the main action which have taken place since the service of the original complaint follows:

On August 23, 1943 David F. Cohen, as holder of 150 shares of respondent's common stock, intervened as a party plaintiff. There then followed litigations in the District Court with respect to applications by the plaintiff for an extensive discovery and inspection. Thereafter the plaintiff and intervener conducted discoveries and inspections over a prolonged period of time. On February 14, 1946,

Hannah Cohen, the executrix of the Estate of Sol Cohen, deceased, was substituted in the place of Sol Cohen, deceased. Pursuant to an order of the District Court, dated February 14, 1946, an amended complaint was filed which, in addition to realleging the original four causes of action, contained five additional causes of action.

Thereafter, and on December 18, 1946, on motion by the individual defendants, alleged causes of action involving claims aggregating more than $90,000,000 were dismissed by the District Court for failure to state a claim upon which relief could be granted. *Cohen v. Beneficial Industrial Loan Corporation*, 69 F. Supp. 297 (D. N. J. 1946).

That the plaintiff and intervener would attempt to involve the Corporation in a $90,000,000 litigation as to which they could not even state a valid claim under the liberal rules of pleading in the federal courts is indicative of the need the respondent corporation has to be protected against the expenses to which it will be subjected if this action proves to be entirely lacking in merit.

On August 1, 1946 respondent made a motion for an order requiring petitioners to furnish security pursuant to Chapter 131 of the New Jersey Laws of 1945, thereby enabling the respondent to recover against the plaintiff and intervener the reasonable expenses to which it would be subject if the action proves to be unmeritorious. It was not disputed that all the statutory requirements were satisfied. The shares held by both petitioners never exceeded 0.0125% of respondent's capital stock and never had a total market value in excess of $8,062.50 (R. 13). Nor is there any dispute that respondent would be liable, in addition to the expense incurred directly by it in relation to the prosecution of the action, for the expenses, including the fees of

ounsel and accountants, incurred by its officers and direc-
ors in connection with a successful defense of the action.

Under the statute it was, therefore, mandatory upon
he District Court to require the petitioners to furnish
ecurity for the reasonable expenses to which respondent
ould be subjected. However, the District Court denied
espondent's motion on the ground that Chapter 131 of the
ew Jersey Laws of 1945 was procedural in nature and
ot binding on the federal District Court.

The Court of Appeals for the Third Circuit held that
1) the order of the District Court denying the motion was
eviewable by a direct appeal; (2) the statute in question
as binding on the federal court, under the doctrine of *Erie*
. R. v. *Tompkins*, 304 U. S. 64 (1938), *Guaranty Trust Co.*
. *York*, 326 U. S. 99 (1945), and *Angel* v. *Bullington*, 330
. S. 183 (1947), since the statute conferred a new substan-
al right on the corporation and since it embodied an impor-
ant public policy of the State of New Jersey, and (3) the
ontentions of the petitioners that the New Jersey statute
as unconstitutional were without merit.

Questions Presented.

(1) Whether the order of the District Court was review-
ble by direct appeal.

(2) Whether Chapter 131 of the New Jersey Laws of
945 is binding on the federal District Court (a) under the
octrine of *Erie R. R.* v. *Tompkins*, or (b) under Local Rule
of the District Court for the District of New Jersey.

(3) Whether Chapter 131 of the New Jersey Laws of
45 is constitutional.

Reasons for Denying the Writ.

1. The petition does not raise any question which warrants review by this Court. For twice within recent months, questions identical with those raised by the instant petition have been submitted to this Court, and twice this Court has refused to review them. These cases, both coming up from the Court of Appeals for the Second Circuit, are *Aspinook Corporation* v. *Bright*, 333 U. S. 846 (March 8, 1948), and *Donovan* v. *Queensboro Corporation*, 69 S. Ct. 45 (October 11, 1948). In the *Aspinook* case the District Court for the Southern District of New York had denied the motion of a corporation for security under a New York statute similar to the one here involved; and in the *Donovan* case the District Court for the Eastern District of New York had granted such a motion. In both cases, review of the decision of the Court of Appeals was sought by writ of certiorari, and in the alternative, direct review of the order of the District Court was sought by common law writ of mandamus or certiorari.

Further, there can be no reasonable doubt that the decision of the Court of Appeals for the Third Circuit here involved is correct for the following reasons: (a) The order of the District Court was reviewable by direct appeal because it finally and completely deprived the petitioner of a substantial right in a proceeding which was separate and distinct from the main action both as to parties and the subject matter; (b) Chapter 131 of the New Jersey Laws of 1945 is binding on the federal District Court whose jurisdiction was based solely on diversity of citizenship, because it creates a new substantial right in favor of a corporation and embodies an important public policy of the State of New Jersey; and (c) Chapter 131 is clearly con-

stitutional because there is no basis whatever for a judicial finding that the conditions which New Jersey attached to the prosecution of a derivative action in its courts, were arbitrary and unreasonable.

2. The only new factor, which was not presented in the *Aspinook* and *Donovan* cases, *supra,* is that the decision of the court below, in so far as it held that the order of the District Court was appealable, conflicts with an unreported decision of the Court of Appeals for the Second Circuit rendered in the *Aspinook* case, holding that such an order was not appealable. This conflict is limited to the one single question of appealability. We submit that this conflict does not involve an important question of federal law which should be reviewed by this Court. It is not a question of law which has general application, because it turns on the particular type of a state statute and there are only three states which have statutes similar to the subject statute and two of these are within the Third Circuit. Further, this Court has already indicated that it did not consider the question of appealability of sufficient importance to be reviewed by a writ of certiorari. *Donovan* v. *Queensboro Corporation,* 69 S. Ct. 45 (1948).

We shall now show that the decision of the court below was clearly correct.

ARGUMENT.

I.

The order of the District Court was appealable.

The petitioners argue that the order of the District Court was not a final order, and hence not appealable, because, in refusing to apply the statute, the order merely denied the respondent security for reimbursement for expenses and counsel fees, but did not bar the respondent's right to obtain such reimbursement upon the termination of the action. The petitioners' contention is clearly repudiated by the express provisions of the statute.

While the statute speaks in terms of "security", it actually creates a new liability on the part of the unsuccessful plaintiff to reimburse the corporation for resulting expenses, including counsel fees of individual defendants. The statute requires the furnishing of "security for the reasonable expenses * * * to which the corporation shall have recourse in such amount as the court * * * shall determine upon the termination of such action". Apart from this right of "recourse" to the so-called "security", the statute creates no right of reimbursement and no such right exists independently of the statute. Thus, by requiring the payment into court of a sum of money designated as "security", the statute creates the corporation's right to receive, and the plaintiff's obligation to give, reimbursement. Since the corporation's right is limited to recourse against the so-called "security", it follows that it will be impossible for the corporation to have any right of reimbursement unless security is given. As was said by the New York Court of Appeals with respect to a substantially identical statute, it "gives to corporations rights

which they had not previously enjoyed" (*Shielcrawt* v. *Moffett*, 294 N. Y. 180, 190, 61 N. E. (2d) 435, 440 (1945)).

Once the true nature of the new right created by Chapter 131 is analyzed, it is clear that the order of the District Court was a final appealable decision for the following reasons:

1. The order finally and completely disposes of a substantial right of the respondent corporation.

Under the statute, the corporation may require the posting of security "at any stage of the proceeding *before* final judgment". It is obvious, and not disputed here, that the statute refers to the final judgment of the trial court. See *Matter of Bailey*, 265 App. Div. 758, 761, 40 N. Y. S. (2d) 746, 749 (1st Dept. 1943), aff'd 291 N. Y. 534, 50 N. E. (2d) 653 (1943). Unless security is obtained before such final judgment, the corporation cannot obtain reimbursement from an unsuccessful plaintiff-stockholder. Thus, after the final judgment in the main action, the question of security and reimbursement for expenses would be moot and appellate review of the instant order would be meaningless, because even if the District Court's order denying security is reversed on appeal from the final judgment, the petitioners could no longer be required to give security, since the respondent's statutory right to security expires upon the entry of the final judgment. Unless permitted to appeal directly from the order of the District Court, the respondent thus would irretrievably lose the right conferred upon it by the New Jersey statute and suffer damage in excess of $100,000. As pointed out by Judge Frank in his concurring opinion in *Aspinook Corp.* v. *Bright*, 165 F. (2d) 294, 295 (C. C. A. 2d, 1947), in such case a corporation "will suffer an irreparable loss through an unreviewable erroneous order of the district court".

It is well settled that an order which, as here, would irreparably injure a party by depriving it of a substantial

right with absolute finality, is a final decision within the meaning of the jurisdictional statute.

Thus, in *Gumbel* v. *Pitkin*, 113 U. S. 545 (1885), an order denying a petition for intervention was held to be appealable, this Court saying (at p. 548):

> "The order dismissing Gumbel's intervention disposes of his rights, and is a final judgment as to that issue, as to which he has a right to a writ of error."

In *Ex parte Tiffany*, 252 U. S. 32 (1920), an order in a receivership suit was held to be final and appealable which denied an application of a state receiver to require the federal receiver to turn the property of the insolvent over to him. The Court said (at p. 36):

> "It is clear that the order made in the District Court refusing to turn over the property to the chancery receiver was a final decision * * * from which the chancery receiver had the right to appeal to the Circuit Court of Appeals. By the order the right of the state receiver to possess and administer the property of the corporation was finally denied."

In the instant case, the right of the respondent corporation to obtain reimbursement for counsel fees and expenses was finally denied by the District Court.

In *American Brake Shoe & Foundry Co.* v. *New York Rys.*, 282 Fed. 523 (C. C. A. 2d, 1922), app. dismissed *sub nom. Eighth Avenue R. R.* v. *Hedges*, 262 U. S. 736 (1923), an order made in a receivership suit was held appealable which denied the claims of certain creditors to immediate payment and deferred consideration of their claims until the final receivership accounting. Judge Rogers, speaking for the Court, said (at p. 527):

> "An adjudication is a final appealable order, if

> against a party in such a manner as leaves him no adequate relief, except by recourse to an appeal. * * * If the petitioners have a right of immediate payment, the orders must be regarded as a determination and denial of a substantial right, and which leave no adequate relief, except by recourse to an appeal. As such we have a right to review them."

2. The order determines a matter distinct from the general subject of litigation.

The applicable rule of law has been summarized as follows in 10 *Cyc. Fed. Procedure* (2d ed., 1943), p. 231:

> "The term 'final decision' as employed in the jurisdictional statute does not mean necessarily such decisions or decrees only which finally determine all the issues presented by the pleadings. While these are undoubtedly final decisions, the terms are not limited to them, but also apply to a final determination of a collateral matter distinct from the general subject of litigation, affecting only the parties to the particular controversy, and finally settling that controversy."

Of the many cases in which this Court has announced this well-established rule, it will suffice to refer by way of example to *United States* v. *River Rouge Improvement Co.*, 269 U. S. 411, 414 (1926), where this Court said:

> "While the general rule requires that a judgment of a federal court shall be final and complete before it may be reviewed on a writ of error or appeal, it is well settled that an adjudication final in its nature as to a matter distinct from the general subject of the litigation and affecting only the parties to the particular controversy, may be reviewed without awaiting the determination of the general litigation."

The instant order falls within this rule for two reasons: (1) Because of the alignment of the parties to the con-

troversy it determines, and (2) because of the subject matter of that controversy.

The fundamental difference between the instant controversy and the main action leaves no doubt as to its collateral nature. The main action is brought on behalf of the respondent corporation, which is merely a formal party thereto and has, therefore, submitted its rights to the protection of the court. In the instant controversy, on the other hand, the respondent seeks to enforce rights of its own against the petitioners, so that for the purpose of this proceeding its position with respect to them becomes truly adversary in character. Furthermore, the individual defendants, who are the real parties in interest in the main action, are not involved in the instant controversy and will be in no way affected by its disposition. The controversy thus clearly falls within the doctrine of the *River Rouge Improvement Co.* case, *supra*, as "a matter distinct from the general subject of the litigation and affecting only the parties to the particular controversy."

The same result follows from the nature of the right asserted in the instant controversy, namely a right to counsel fees and expenses. A controversy involving such a right has been held to be, without more, a collateral matter, having a distinct and independent character. In *Trustees v. Greenough*, 105 U. S. 527 (1881), this Court held an order awarding expenses and counsel fees to the plaintiff in a representative bondholder's suit to be appealable, saying (at p. 531):

> "The first question, however, is whether these orders do or do not amount to a final decree, upon which an appeal lies to this court. They are certainly a final determination of the particular matter arising upon the complainant's petition for allowances, and direct the payment of money out of the

fund in the hands of the receiver. Though incidental to the cause, the inquiry was a collateral one, having a distinct and independent character, and received a final decision."

In *Sprague* v. *Ticonic Bank*, 307 U. S. 161 (1939), the aintiff had petitioned the District Court for the allowance counsel fees and expenses, after the merits of the action d been finally decided by this Court. The District Court ld that it had no authority to grant the petition on the ound that it had no further function to perform other an to carry out the mandate of the Supreme Court. he Circuit Court of Appeals affirmed for the reasons ated by the District Court, and for the further reason at the term of court at which the decree was entered d long since passed. This Court reversed on the ground at under the doctrine of *Trustees* v. *Greenough, supra*, e issue of an allowance of counsel fees was separate d distinct from the main litigation and was, therefore, t covered by either the original decree or the appellate andates. As to the requirements of terms of court, the ourt said (at p. 170):

> "Since we view the petition for reimbursement as an independent proceeding supplemental to the original proceeding and not a request for a modification of the original decree; the suggestion of the Circuit Court of Appeals—that it came after the end of the term at which the main decree was entered and therefore too late—falls."

The grounds on which the petitioners seek to distinish *Trustees* v. *Greenough* and *Sprague* v. *Ticonic Bank*, *upra*, are clearly untenable. The *Greenough* case is sought be distinguished because the order there involved an ward of expenses and counsel fees, and not security there-

for. But, as has been shown *supra*, this attempt to differentiate between the right to security and the right to reimbursement for expenses and counsel fees rests upon a complete misunderstanding of the meaning and effect of Chapter 131. Under the New Jersey statute, it is the posting of the security which creates the respondent's right to reimbursement. Thus, the respondent's motion under Chapter 131 was an assertion of its right of reimbursement for counsel fees and expenses and as such was of the same nature as the application in the *Greenough* case. That case is further sought to be distinguished because it granted the motion, whereas here the motion was denied by the District Court. However, that factor is entirely immaterial. If the proceedings instituted by the respondent's motion were collateral and separate and distinct from the main litigation, any determination of such collateral proceeding is a final appealable decision. Reference is made in this connection to *Gelberg* v. *Richardson*, 82 F. (2d) 314 (C. C. A. 9th, 1936), where an order *denying* an application for counsel fees was held to be a final appealable decision. The petitioners' analogy to summary judgment is clearly inapplicable, for a motion for summary judgment does not relate to a matter distinct from the issues of the litigation, but on the contrary seeks a determination of those very issues.

The petitioners seek to distinguish the *Sprague* case on the ground that there the motion for expenses and counsel fees was made after a determination for the merits. But the court below relied on the *Sprague* case merely for the proposition that an issue respecting the allowances of counsel fees and expenses is separate and distinct from the main litigation. This Court clearly so held in the *Sprague* case. It follows that the instant order, which determined such an issue, was a final appealable decision.

II.

Chapter 131 of the New Jersey Laws of 1945 is binding on a Federal District Court sitting in New Jersey.

The decision of the court below that the statute in question was binding on the federal court is clearly correct because of the following three reasons:

1. The statute conferred upon corporations a substantial right within the meaning of *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945); and under that case it is immaterial whether the statute can be classified as "procedural" for some purposes. As shown above, the statute created a new right in favor of corporations against stockholders prosecuting derivative actions. There can be no doubt that this new right is a substantial one. The expense of defending a derivative action, including accountants' and attorneys' fees, may be very substantial and is certain to be so in a case involving complicated transactions of a large corporation. For example, in *Donovan* v. *Queensboro Corp.*, 75 F. Supp. 131 (E. D. N. Y. 1947), the court fixed the amount of the initial security to be given at $50,000. The right created by the statute in question is designed to protect the corporation and 95% of its stockholders from being subjected to a substantial loss by a minority stockholder unsuccessfully pursuing a remedy which is supposed to be for the benefit of the corporation.

That such right is a substantial one, follows *a fortiori* from *Sioux County* v. *National Surety Co.*, 276 U. S. 238 (1928), where it was held that a state created right to counsel fees must be enforced by the federal courts. For in the instant case, the right covers all expenses, including

accountants' and attorneys' fees, whereas in the *Sioux County* case the expenses were limited to *attorneys'* fees incident to the prosecution of action on insurance contracts.

2. The statute in question represents an important public policy of the State of New Jersey, designed to cope with an evil which the Legislature found to exist. Under *Angel* v. *Bullington*, 330 U. S. 183 (1947), such public policy of the State may not be thwarted by recourse to the federal court.

3. Even if Chapter 131 did not create a substantial right and did not embody an important public policy of the State, it would still have to be enforced under the District Court's Local Rule 15, which provides as follows:

> "*Applicability of State Court Procedure.* In circumstances not provided for by the Federal Rules of Civil Procedure, or by these rules, the procedure and practice of the Courts of the State of New Jersey shall govern."

It is well settled that rules of court, unless directory and merely for the protection of the court, have the force of law and a federal court has no power to suspend or modify retroactively any rule which it has made. *Rio Grande Irrigation and Colonization Co.* v. *Gildersleeve*, 174 U. S. 603 (1899); *Weil* v. *Neary*, 278 U. S. 160 (1929).

The petitioners' arguments to the contrary are invalid.

In the first place, petitioners argue that the order of the District Court was merely concerned with the "procedural" matter of furnishing security and had nothing to do with any right of the respondent to be reimbursed for expenses. As shown above, this argument is completely fallacious. For under the statute, the denial of "security"

at the same time denies any right to reimbursement for the expenses in question. The petitioners misconceive the nature of the statute when they assert that the posting of security and the creation of the right of reimbursement are "two distinct questions". The right to reimbursement is limited to, and created by, the security which is posted.

In the second place, the petitioners' argument that Rule 23 of the Federal Rules of Civil Procedure prevents the application of the New Jersey statute is entirely devoid of merit. Rule 23 is entirely different from Chapter 131. It does not give a corporation any right whatever to obtain reimbursement for expenses to which it may be subjected as a result of an unmeritorious derivative action. Rule 23 does not deal with that subject at all. Chapter 131 is thus in no way inconsistent with Rule 23. Carried to its logical conclusion, the petitioners' position would lead to the absurd result that all state law relating to derivative stockholders' suits has been superseded by Rule 23 in the federal courts.

III.

Chapter 131 of the New Jersey Laws of 1945 is constitutional.

It is significant that in attacking the constitutionality of Chapter 131 under Point III of their brief, the petitioners have made no serious attempt to show that the statute affects any property rights of stockholders and fail to take issue with the statement in the opinion of the court below (R. 59) that:

> "The right to bring a stockholder's derivative suit is not a property right and as this court held in *Overfield* v. *Pennroad Corporation*, 146 F. 2d 889,

> 894. * * * the individual stockholder is permitted to sue 'simply to set in motion the judicial machinery of the court.'"

In the recent case of *Myer* v. *Myer*, 271 App. Div. 465, 473, 66 N. Y. S. (2d) 83, 91 (1st Dept. 1946), aff'd 296 N. Y. 979, 73 N. E. (2d) 562 (1947), the rule is stated as follows:

> "A stockholder has no right to institute action in his own behalf, but only on behalf of the corporation.
>
> * * * * * *
>
> "The right that the plaintiffs have * * * to sue in the name of and for the benefit of the corporation * * *, is a contingent right of action only. Insofar as it may be of benefit to the stockholder personally the property right is a remote and insubstantial one * * *. Under these circumstances we do not deem the right is one that may demand protection against legislative regulation * * * The situation might be different if the stockholder had a right of personal recovery against the officers and directors and was prevented from pursuing his remedies as a creditor as to some accrued claim. * * *
>
> "*Here the corporation was the creditor and its rights remained unabridged.*" (Italics ours.)

Since the prosecution of a derivative action does not involve a property right of the stockholder, it is impossible for the New Jersey statute, regulating the prosecution of such an action, to impair any property right of the petitioners; and for that reason alone, their attack on the constitutionality of Chapter 131 must fail. We shall, however, briefly show that even if the petitioners' property rights were involved, the arguments ar unsound.

1. Chapter 131 does not violate the due process or equal protection clause of the Constitution.

(a) With the exception of a decision of this Court (*Gulf, C. & S. R. R.* v. *Ellis*, 165 U. S. 150 (1897)) which on its facts has no bearing on the question here involved, the only authorities relied on by petitioners in support of their argument that the statute violates the equal protection clauses are two law review articles. Opposed to their contention is a long line of cases upholding the legislation here involved, culminating in the decision of the New York Court of Appeals in *Lapchak* v. *Baker*, 298 N. Y. 89, 80 N. E. (2d) 751 (1948). It is, of course, well settled that a statute may be struck down as violative of the equal protection clause only if the classification has no rational basis whatever. Where the reasonableness of the statute is debatable at all, it must be upheld. *Zahn* v. *Board of Public Works*, 274 U. S. 325 (1927). Here, the Legislature found that a grave evil existed in the abuse of derivative suits, which inflicted severe financial losses on corporations. Surely, it was rational for the Legislature to recognize a distinction between plaintiffs who have and who do not have a substantial interest in the effect of the litigation on the welfare of the corporation, and accordingly to establish a classification on the basis of a minimum interest in the corporation. Such classification has been widely adopted in the general law of corporations in fixing the rights of stockholders. The fact that groundless suits may possibly also be brought by some not included in the class and not subject to Chapter 131 does not make the statute arbitrary and unreasonable. It is well settled that the Constitution merely requires that a classification rest on some rational basis; it does not require that it be free from all possible imperfections and it permits the Legislature

of the State to exercise its own judgment as to the line to be drawn. *Missouri, K. & T. Ry.* v. *Cade*, 233 U. S. 642 (1914); *West Coast Hotel Co.* v. *Parrish*, 300 U. S. 379 (1937).

(b) As to the due process clause, petitioners do not cite any authorities in support of their position. Again, the applicable case law is all the other way. Moreover, it is clear that the remedy selected by the Legislature for the evil found by it to exist was reasonable. The statute does not prohibit the prosecution of a derivative action by any stockholder, but merely subjects it to a reasonable condition. The power of the Legislature to subject the prosecutions of actions to conditions precedent cannot be questioned. *Jones* v. *Union Guano Co.*, 264 U. S. 171 (1924). This Court has, moreover, consistently held that it is reasonable and constitutional to condition the prosecution or defense of a cause of action on the assumption of liability for the adversary's reasonable counsel fees. *Life & Casualty Co.* v. *McCray*, 291 U. S. 566 (1934); *Dohany* v. *Rogers*, 281 U. S. 362 (1930); *Sioux County* v. *National Surety Co.*, 276 U. S. 238 (1928); *Missouri, K. & T. Ry.* v. *Cade*, 233 U. S. 642 (1914). Nor is it unreasonable to condition the prosecution of an action on the posting of security. Indeed, in *Gant* v. *Oklahoma City*, 289 U. S. 98 (1933), this Court held that the enjoyment and use of one's own property may be conditioned on putting up security. The Court there upheld the constitutionality of a city ordinance which provided that no oil well should be drilled within the city limits until there should be filed with the city clerk a bond in the sum of $200,000 covering each well. *A fortiori*, it must be permissible to subject the prosecution of a derivative stockholder's action to such a condition, where the stockholder does not assert his own property rights, but merely acts

as an instigator for the protection of the corporation's property rights, and where loss and damage will be inflicted on the corporation if the action is unsuccessful.

2. Chapter 131 does not violate the full faith and credit clause.

The question of full faith and credit was not raised by the petitioners in the court below. In any event, their argument that the full faith and credit clause prevents the application of the statute to a Delaware corporation has no merit.

It is clear that no question arises under the full faith and credit clause, where the application of the local law is justified by established principles of conflict of laws. In this case, Chapter 131 is expressly made applicable to foreign corporations. There can be no doubt that New Jersey had a sufficient governmental interest to make the statute so applicable. Chapter 131 merely regulates the conditions on which causes of action may be prosecuted in the New Jersey courts, and hence merely imposes conditions on the performance of acts in New Jersey. Thus, New Jersey has the superior, if not the sole, governmental interest in the matter.

That the statute here in issue is of the type which the local forum may apply under settled rules of conflict of laws, was held in *Shieleraut* v. *Moffett*, 184 Misc. 1074, 56 N. Y. S. (2d) 134 (Sup. Ct., N. Y. Co., 1945), where the court said (184 Misc. at p. 1077, 56 N. Y. S. (2d) at p. 136):

> "* * * it seems to me that a major concern is whether section 61-b is procedural in the sense that it is the type of statute which our courts may apply conveniently, practically and properly to foreign corporations doing business in this state to the end that our procedure shall maintain a desirable measure of uniformity in derivative stockholders' suits.

> I believe that section 61-b, and it must therefore follow, its New Jersey counterpart, are procedural in that sense."

It is, of course, perfectly consistent to hold a statute to be "procedural" for conflict of laws purposes, while at the same time holding it to be binding on a federal court as embodying an important public policy and creating a substantial right. An example is *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945), holding a state statute of limitations to be "substantive" for the purpose of the doctrine of *Erie R. R.* v. *Tompkins*, although it is concededly "procedural" for conflict of laws purposes.

3. "Retroactive" application of Chapter 131 does not violate the Constitution.

The constitutionality of the application of the statute to stockholders who acquired their shares prior to its enactment has been squarely upheld by the New York Court of Appeals in *Myer* v. *Myer, supra,* 296 N. Y. 979, 73 N. E. (2d) 562 (1947), aff'g 271 App. Div. 465, 66 N. Y. S. (2d) 83 (1st Dept. 1946). If the statute is properly applicable to plaintiffs who became stockholders prior to its enactment, it is immaterial whether or not suit was pending at that time. The nature of the right involved is exactly the same before and after a complaint is filed. Thus, the highest court of the State of New Jersey has expressly held that statutes creating a right to counsel fees may constitutionally be applied to pending actions. *Igoe Bros.* v. *National Surety Co.*, 112 N. J. L. 243, 169 Atl. 841 (1934). Hence, the petitioners' contentions that such application would violate the due process and contracts clauses of the Constitution are without merit. With re-

spect to the contracts clause argument on page 22 of petitioners' brief, it should be pointed out that both *Coombes* v. *Getz* and *Hathorn* v. *Calef*, on which petitioners rely, do not relate to the relationship between stockholder and corporation, but between creditor and corporate debtor. These cases have thus no bearing on the question here involved. On the other hand, it has been expressly held that the right to bring a derivative action is not a contract right. *Myer* v. *Myer*, *supra*.

Conclusion.

The petition for certiorari should be denied.

Respectfully submitted,

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Supreme Court of the United States

OCTOBER TERM, 1948.

No. 442.

HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenor,
Petitioners,

against

BENEFICIAL INDUSTRIAL LOAN CORPORATION,
Respondent,

and

O. W. CASPERSON, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAUL A. SEIBOLD, Individually;
Defendants.

No. 512.

BENEFICIAL INDUSTRIAL LOAN CORPORATION,
Petitioner,

against

Honorable WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey; and HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenors,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR BENEFICIAL INDUSTRIAL LOAN CORPORATION.

These are proceedings to review a decree of the Court of Appeals for the Third Circuit which reversed an order

of the District Court for the District of New Jersey, denying a motion of Beneficial Industrial Loan Corporation for security for expenses and counsel fees, and a decree of that Court dismissing a petition by Beneficial Industrial Loan Corporation for a writ of certiorari or mandamus. This consolidated brief will cover the points raised in both No. 442 and No. 512, and the parties will hereinafter be referred to according to their alignment in No. 442.

Opinions Below.

The opinion of the Court of Appeals (R. 39) is reported in 170 F. 2d 44. The opinion of the District Court (R. 22) is reported in 7 F. R. D. 352.

Jurisdiction.

The jurisdiction of this Court is invoked under 28 U. S. C. §§1254(1) and 2101(c).

The New Jersey Statute and the Nature of the Right Created Thereunder.

All of the questions involved on this review concern the enforcement of rights under Chapter 131 of the New Jersey Laws of 1945 (R. S. Cum. Supp. 14:3-15, 14:3-17), which provides as follows:

> "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares

of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive.

* * * * * *

"This act * * * shall take effect immediately and shall apply to all such actions, suits or proceedings now pending in which no final judgment has been entered, and to all future actions, suits and proceedings."

It will be noted that while the statute speaks in terms of "security", it does not in reality involve security in the accepted meaning of that term. It involves rather the posting of property or a bond which *creates, and measures the limits of, a new obligation.* The statute is to be sharply distinguished from the ordinary "security for costs" statute and similar statutes which provide for security for an existing and independent obligation. While the statute was

not drafted in the *form* of a liability, the fact remains that *in substance* it imposes an obligation on plaintiffs in derivative suits to reimburse corporations by requiring the furnishing of

> "security for the reasonable expenses * * * to which the corporation shall have recourse in such amount as the court * * * shall determine upon the termination of such action."

Apart from this right of recourse to the "security", the statute creates no right of reimbursement and no such right exists independently of the statute. Thus, by requiring the payment into court of a sum designated as "security", the statute creates the corporation's right to receive, and the plaintiff's obligation to give, reimbursement. Since the corporation's right is limited to recourse against the "security", it follows that it will be impossible for a corporation to have any right of reimbursement unless security is given.

Thus, as was said by the New York Court of Appeals with respect to a substantially identical statute, it "gives to corporations rights which they had not previously enjoyed" (*Shielcrawt* v. *Moffett*, 294 N. Y. 180, 190, 61 N. E. 2d 435, 440 (1945)).

Statement of the Case.

The decree of the court below decided a controversy between the respondent corporation and the petitioners, its stockholders, involving the enforcement by respondent against petitioners of its right under Chapter 131 of the New Jersey Laws of 1945 to be reimbursed by the petitioners for expenses and counsel fees in a stockholders' derivative

suit instituted by the petitioners in the right of the respondent.

The proceedings here involved were instituted on August 1, 1946 by the respondent's motion, pursuant to Chapter 131, for an order requiring petitioners to furnish security for the reasonable expenses to which it would be subject if the derivative action proves to be unmeritorious.

It is undisputed that all requirements of Chapter 131 are satisfied. The shares held by both petitioners amount to less than 0.0126% of respondent's capital stock and their total market value never exceeded $8,062.50 (R. 11). And the respondent will be liable, in addition to the expense incurred directly by it in connection with the action, for the expenses, including counsel and accountants' fees, incurred by its officers and directors in connection with a successful defense of the action (R. 10).

The sole issue in the instant proceeding has been purely one of law as to the effect and constitutionality of Chapter 131.

The District Court denied respondent's motion on the ground that Chapter 131 of the New Jersey Laws of 1945 was "procedural" in nature and not binding on the Federal District Court.

The Court of Appeals for the Third Circuit reversed, holding that (1) the order of the District Court denying the motion was reviewable by a direct appeal; (2) the statute in question was binding on the Federal Court, under the doctrine of *Erie R. R.* v. *Tompkins*, 304 U. S. 64 (1938), *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945), and *Angel* v. *Bullington*, 330 U. S. 183 (1947), since the statute conferred a new substantial right on the corporation and since it embodied an important public policy of the State of New Jersey, and (3) the contentions of the petitioners that the New Jersey statute was unconstitutional were without merit.

Questions Presented.

(1) Whether the order of the District Court was reviewable by direct appeal.

(2) Whether the order of the District Court was reviewable by common law writ of certiorari or mandamus, in the event that it was not subject to direct appeal.

(3) Whether Chapter 131 of the New Jersey Laws of 1945 is binding on the Federal District Court (a) under the doctrine of *Erie R. R.* v. *Tompkins*, or (b) under Local Rule 15 of the District Court for the District of New Jersey.

(4) Whether Chapter 131 of the New Jersey Laws of 1945 is constitutional.

Summary of Argument.

We shall show:

(1) The order of the District Court was appealable. It finally and completely disposed of a substantial right of the respondent. It determined a controversy separate and distinct from the main action both as to parties and subject matter. The rights asserted by the respondent under the statute were in no respect conditioned or qualified by the determination of the issues in the main litigation. If the respondent were denied appellate review until the entry of the final judgment in the main litigation, it would mean that respondent would be deprived of all rights under the statute without any effective appellate review.

(2) Even if the order of the District Court were not subject to direct appeal, it was reviewable by common law writ of certiorari or mandamus. The postponement of

appellate review until after final judgment would thwart appellate jurisdiction by rendering it completely ineffective. And, it is clear that the court below would have granted relief by common law writ if it had not held that the order was subject to direct appeal, provided only it had power to issue such a writ.

(3) The statute is binding on the District Court under the doctrine of *Erie R. R.* v. *Tompkins*. It creates a new substantial right in favor of a corporation and embodies an important public policy of the State of New Jersey. If this statute were controlling on the state courts and not controlling on the federal court, it would bring about the very condition which it was the purpose of *Erie R. R.* v. *Tompkins* to eliminate, and federal jurisdiction would be sought merely to avoid the application of an important state statute. Moreover, if the petitioners' contentions were correct as to the *Erie R. R.* v. *Tompkins* doctrine, the statute would still have to be applied under the District Court's Local Rule 15.

(4) There is no substance to the contention that the statute is unconstitutional. It manifestly has a relation to the correction of an evil found by the New Jersey Legislature to exist. The proper forum for the petitioners to present their criticism of the statute is the New Jersey Legislature. The full faith and credit clause has no application. The statute is limited to acts performed within the State of New Jersey, namely, the prosecution of actions in its courts.

ARGUMENT.

I.

The order of the District Court was reviewable by direct appeal.

The order of the District Court denying respondent's motion for security was a final appealable decision within the meaning of 28 U. S. C. § 1291, *infra*, p. 91, on two separate grounds, namely: (1) it finally disposed of a substantial right of the respondent, and (2) it determined a controversy distinct from the general subject matter of the litigation.

1. The order finally disposed of a substantial right of the respondent corporation.

It is well settled that an appeal will be entertained from an order that would irreparably injure a party by depriving it of a substantial right with absolute finality. In the recent case of *Republic Gas Co.* v. *Oklahoma*, 334 U. S. 62 (1948), this Court pointed out that an order that otherwise might be deemed interlocutory is appealable where "the controversy had proceeded to a point where a losing party would be irreparably injured if review were unavailing" (p. 68); or where there is "any immediate threat of irreparable damage * * * rendering postponed review so illusory as to make the decree 'final' now or never" (p. 70). Under this doctrine, it has been held that

> "A final order results where a court denies a petition by an intervening creditor to establish a prior lien (*Gumbel* v. *Pitkin*, 113 U. S. 545, 548), or a petition by a municipal corporation intervening in a foreclosure suit to enforce a lien for taxes superior

to the mortgage (*Savannah* v. *Jesup*, 106 U. S. 563, 564-565), or one by a chancery receiver appointed by a state court for the delivery of property in the possession of another court. *Ex parte Tiffany*, 252 U. S. 32, 36." Mr. Justice Cardozo, speaking for the Court in *Clark* v. *Williard*, 292 U. S. 112, 118 (1934).

The order of the District Court clearly falls within the above rule for it finally and completely deprived respondent of its right of reimbursement and constituted an "immediate threat of irreparable damage * * * rendering postponed review * * * illusory * * *". The only review which could offer any redress to the respondent is an immediate review.

The petitioners argue that the respondent could be fully protected by an appellate review of the order of the District Court after the final judgment in the main action. This argument simply ignores the plain provisions of the statute.

After the final judgment in the main action, the question of security and reimbursement for expenses therefrom would be moot and appellate review of the order would be meaningless. If, at that time, the District Court's order denying security should be reversed on appeal, the petitioners could no longer be required to give security since under the New Jersey statute security may be required only "at any stage of the proceedings *before* final judgment", which means the final judgment of the trial court. See *Matter of Bailey*, 265 App. Div. 758, 761, 40 N. Y. S. 2d 746, 749 (1st Dept. 1943), aff'd 291 N. Y. 534, 50 N. E. 2d 653 (1943).

Unless security is obtained before such final judgment, all rights conferred under the statute would be wholly lost. For as pointed out above on page 4, the right of reim-

bursement for expenses is limited solely to recourse to the "security".

Thus, unless permitted to appeal directly from the order of the District Court, the respondent would irretrievably lose an effective appellate review of an order depriving it completely of the only means of protection against possible damage in excess of $100,000. As pointed out by Judge Frank in his concurring opinion in *Aspinook Corp.* v. *Bright,* 165 F. 2d 294, 295 (2d Cir. 1947), cert. denied 333 U. S. 846 (1948), in such a case a corporation "will suffer an irreparable loss through an unreviewable erroneous order of the district court."

The unreported decision of the divided Court of Appeals for the Second Circuit, referred to in the *Aspinook* case, *supra,* holding without opinion that an order of the kind here in issue was not final and thus not appealable, is, we submit, erroneous.

It appears from the record in the *Aspinook* case that the court was not sufficiently informed as to the authorities, the principles of law, and the effect of the statute involved. The motion to dismiss the appeal was heard on only 5 days' notice. No memorandum or brief was submitted in opposition to the motion. The only paper submitted in opposition was a 6-page affidavit, which had no citation of authorities and which failed to give an adequate analysis of the principles and facts involved.

It is apparent from the opinion in *Aspinook Corp.* v. *Bright, supra,* where the court denied the corporation's petition for mandamus (after having dismissed its appeal), that it misunderstood the nature of the statute and the effect of the order before it. The basic question before the court on both the motion to dismiss the appeal and the petition for mandamus was whether the corporation would be finally deprived of rights under the statute without an

immediate review. The premise adopted by the majority of the court in dealing with this basic question is shown by the following statement in such opinion (165 F. 2d, at p. 295):

> "Here, if after final judgment either party appeals to this court, full review and protection of the parties can be afforded; only in the single instance where judgment goes against the suing plaintiffs *and* they choose not to appeal will there be the chance of the corporation suffering loss * * *."

This premise is untenable. Contrary to the above quoted statement, the corporation could receive the protection to which it was entitled under the statute *in no instance* without having a right to an immediate review.

In the first place, a plaintiff might abandon the prosecution of the action at any stage before final judgment, and after subjecting the corporation to very substantial expenses. Here, there would be no final judgment to be appealed and hence under the *Aspinook* decision, the corporation would have finally and completely lost its rights under the statute.

In the second place, as has been pointed out, *supra*, the statute expressly limits the requirement for security to any stage "*before* final judgment". Therefore, after final judgment, the corporation is no longer entitled to security and even if an appeal should be taken from the final judgment, whether by the plaintiff or the individual defendants, the motion for security would have become moot. Thus, under the *Aspinook* decision, the corporation would be finally deprived of all rights under the statute.

In the third place, even under the erroneous assumption made in the *Aspinook* decision that if "either party" appealed from an adverse final judgment, the appellate court

could order security to be given, the corporation would still have been finally deprived of the protection given by the statute. For the plaintiff could then refuse to put up the security with impunity, and leave the corporation to bear the expenses to which it has already been subjected.

In any event, review of the order on appeal from the final judgment in the main action can never give to the corporation the kind of protection to which it is entitled under the statute, namely, security before the damage is inflicted. A basic purpose of security is to eliminate the risk of collectibility and no decision of an appellate court can eliminate that risk after the damage has been done.

The fact that the Court of Appeals for the Second Circuit misunderstood the question of law before it is well illustrated by the statement which it made with respect to the instance in which it recognized that the corporation would be denied the protection of the statute. It said (165 F. 2d, at p. 295): "Such burdens accompanying success in litigation are of course usual in our jurisprudence; * * *." This instance was the case where the plaintiff failed to appeal from an adverse judgment. Obviously, a judgment denying a recovery for the benefit of the corporation would not constitute "success in litigation" so far as the corporation is concerned. The only result of the litigation as to it would be the loss which the statute was designed to prevent. Moreover, whatever the burdens might be in a litigation in the absence of statutory protection, constitutes no reason for ignoring a statute which is expressly designed to eliminate such burdens.

There is no doubt that in the absence of immediate review the respondent would suffer irreparable injury by being deprived of its right to security and reimbursement with absolute finality.

2. The order determined a controversy distinct from the general subject matter of the litigation.

Another well-established basis for the appealability of the order is the doctrine which has been summarized as follows in 10 *Cyc. Fed. Procedure* (2d ed., 1943), p. 231:

> "The term 'final decision' as employed in the jurisdictional statute does not mean necessarily such decisions or decrees only which finally determine all the issues presented by the pleadings. While these are undoubtedly final decisions, the terms are not limited to them, but also apply to a final determination of a collateral matter distinct from the general subject of litigation, affecting only the parties to the particular controversy, and finally settling that controversy."

Of the many cases in which this Court has announced this rule, it will suffice to refer by way of example to *United States* v. *River Rouge Improvement Co.*, 269 U. S. 411, 414 (1926), where this Court said:

> "While the general rule requires that a judgment of a federal court shall be final and complete before it may be reviewed on a writ of error or appeal, it is well settled that an adjudication final in its nature as to a matter distinct from the general subject of the litigation and affecting only the parties to the particular controversy, may be reviewed without awaiting the determination of the general litigation."

The present order falls within this rule for two reasons: (a) Because of the alignment of the parties to the controversy it determines, and (b) because of the subject matter of that controversy.

The fundamental difference between the instant controversy and the main action leaves no doubt as to its collateral nature. The main action is brought on behalf of

the respondent corporation, which is merely a nominal party thereto, by the petitioners against the individual defendants. In the instant controversy, on the other hand, the respondent seeks to enforce rights of its own against the petitioners, so that in this proceeding the litigation is between the respondent and the petitioners; and none of the individual defendants are involved in this controversy and will be in no way affected by its disposition. The controversy thus falls within the doctrine of the *River Rouge Improvement Co.* case, *supra,* as "a matter distinct from the general subject of the litigation and affecting only the parties to the particular controversy."

The same result follows from the nature of the right asserted in this controversy, namely, a right to counsel fees and expenses. A controversy involving such a right has been held to be, without more, a collateral matter, having a distinct and independent character. In *Trustees* v. *Greenough,* 105 U. S. 527 (1881), this Court held an order awarding expenses and counsel fees to the plaintiff in a representative bondholder's suit to be appealable, saying (at p. 531):

> "The first question, however, is whether these orders do or do not amount to a final decree, upon which an appeal lies to this court. They are certainly a final determination of the particular matter arising upon the complainant's petition for allowances, and direct the payment of money out of the fund in the hands of the receiver. Though incidental to the cause, the inquiry was a collateral one, having a distinct and independent character, and received a final decision."

In *Sprague* v. *Ticonic Bank,* 307 U. S. 161 (1939), the plaintiff had petitioned the District Court for the allowance of counsel fees and expenses, after the merits of the action

had been finally decided by this Court. The District Court held that it had no authority to grant the petition on the ground that it had no further function to perform other than to carry out the mandate of the Supreme Court. The Circuit Court of Appeals affirmed for the reasons stated by the District Court, and for the further reason that the term of court at which the decree was entered had long since passed. This Court reversed on the ground that under the doctrine of *Trustees* v. *Greenough, supra,* the issue of an allowance of counsel fees was separate and distinct from the main litigation and was, therefore, not covered by either the original decree or the appellate mandates. As to the requirements of terms of court, the Court said (at p. 170):

> "Since we view the petition for reimbursement as an independent proceeding supplemental to the original proceeding and not a request for a modification of the original decree, the suggestion of the Circuit Court of Appeals—that it came after the end of the term at which the main decree was entered and therefore too late—falls."

The grounds on which the petitioners seek to distinguish *Trustees* v. *Greenough* and *Sprague* v. *Ticonic Bank, supra,* are untenable. The *Greenough* case is sought to be distinguished because the order there involved an award of expenses and counsel fees, and not security therefor. But, as has been shown *supra,* this attempt to differentiate between the right to security and the right to reimbursement for expenses and counsel fees rests upon a misunderstanding of the meaning and effect of Chapter 131. Under the New Jersey statute, it is the posting of the security which creates the respondent's right to reimbursement. Thus, the respondent's motion under Chapter 131 was an assertion of its right of reimbursement for counsel fees

and expenses and as such was of the same nature as the application in the *Greenough* case. That case is further sought to be distinguished on the ground that there the motion was granted, whereas here the motion was denied. If a proceeding is collateral and separate from the main litigation, *any* determination thereof is a final appealable decision. Reference is made in this connection to *Gelberg* v. *Richardson*, 82 F. 2d 314 (9th Cir. 1936), where an order *denying* an application for counsel fees was held to be a final appealable decision. Finally, the petitioners' analogy to summary judgment is inapplicable, for a motion for a summary judgment does not relate to a matter distinct from the issues of the litigation, but on the contrary seeks a determination of those very issues.

The petitioners seek to distinguish the *Sprague* case on the ground that there the motion for expenses and counsel fees was made after a determination of the merits. But the court below relied on the *Sprague* case merely for the proposition that an issue respecting the allowances of counsel fees and expenses is separate and distinct from the main litigation. This Court clearly so held in the *Sprague* case. It follows that the instant order, which determined such an issue, was an appealable decision.

The two main arguments advanced by petitioners to support their contention that the order of the District Court did not determine a separate controversy have no merit.

In the first place, they argue that in order to have a separate controversy the question "must be so distinct and unrelated to the other issues in the case that further proceedings in the trial court can have no effect on the question sought to be appealed". Even if the test stated by the petitioners be adopted (and, as shown above, that is not the accurate test), the facts with respect to the

matter decided by the order of the District Court fully meet the test. Further proceedings in the trial court with respect to the main action can have no effect whatever on the question of whether or not respondent has a right to require the petitioners to put up security to protect it against loss. To be sure, the proceedings in the trial court with respect to the merits of the main action will have a relationship to whether or not respondent suffers a loss and hence should have recourse against such security. But that is not the controversy which was before, or was determined by, the District Court. The controversy which was before the District Court, namely, whether or not the petitioner had a right to be protected with security from which reimbursement might be obtained, is in no way conditional upon, or qualified by, the further proceedings in the trial court in the main action.

In the second place, the petitioners argue that "if the denial of security is an independent decision, so too * * * would be an order fixing the amount of the security or amending or refusing to amend it"; and that the necessary consequence would be numerous "interlocutory appeals". We submit that this is wholly imaginary. The fixing of the amount of the security rests in the discretion of the District Court. That is a far cry from a determination of whether or not the respondent has *any* right at all under the statute in question. There is no reason to believe that once the appellate courts settle the basic question as to whether the corporation has a right to proceed under the statute, the district judges will fix the amount of security arbitrarily in unreasonable amounts. Moreover, the determination as to whether or not a corporation may proceed under the statute involves a final and complete determination; whereas the fixing of the amount of security from time

to time might well be regarded as interlocutory steps taken within one proceeding to enforce the rights conferred by the statute.

II.

Even if the order of the District Court was not subject to direct appeal, it was reviewable by common law writ of certiorari or mandamus.

Even if the order should be held not to be an appealable final decision, the court below had authority to review it by common law writ of certiorari or mandamus.

It is, of course, not open to doubt that under 28 U. S. C. §1651(a), *infra*, p. 91, the court below has power to issue the common law writs in aid of its appellate jurisdiction.

> *Ex parte Peru*, 318 U. S. 578, 584 (1943);
> *McClellan* v. *Carland*, 217 U. S. 268, 279 (1910).

And the present case meets all the requirements for the exercise of that power.

(1)

The court below clearly had appellate jurisdiction with respect to the order of the District Court. Even if the order was not directly appealable, it was subject to appellate review by the court below on appeal from the final judgment in the main action. The Court of Appeals was apparently of the opinion that such potential appellate jurisdiction was not sufficient to confer jurisdiction to issue a common law writ, saying (R. 43-44):

> "If the order of the court below is not appealable we would not have the right to issue the writ

since insofar as the instant litigation is concerned this court would have no appellate jurisdiction to protect."

However, this view is clearly erroneous. In the first place, if review of an order by common law writ may be had only if such order is directly appealable, there would never be a need for the issuance of the writ and the court's jurisdiction to issue such writ would for all practical purposes be abolished. In the second place, ever since the decision of this Court in *McClellan* v. *Carland, supra;* it has been settled law that in a proper case the common law writs may be issued in aid of the court's *potential* appellate jurisdiction, before actual appellate jurisdiction has been obtained. In the *McClellan* case, this Court said (217 U. S. at pp. 279-280):

> "In this case it appears that the original action commenced in the Circuit Court of the United States might have been taken on appeal to the Circuit Court of Appeals. * * * There are not wanting decisions in the Federal courts holding different views as to the right to issue such writs as are involved in this case, before the appellate court has actually obtained jurisdiction of the case. There are expressions in opinions of this court to the effect that such writs issue in aid of a jurisdiction actually acquired. But we think it the true rule that where a case is within the appellate jurisdiction of the higher court a writ of mandamus may issue in aid of the appellate jurisdiction which might otherwise be defeated by the unauthorized action of the court below."

Accord:

Ex parte United States, 287 U. S. 241, 246 (1932); *United States* v. *District Court*, 334 U. S. 258, 263 (1948).

There can thus be no doubt that the court below had the power to issue a common law writ to bring the order of the District Court before it for review.

(2)

The instant case is an appropriate one for the exercise of the court's power to issue a common law writ in aid of its appellate jurisdiction. It is well settled that the issuance of such writ is proper where otherwise appellate review of the ruling of the lower court would be thwarted. As this Court said in *United States* v. *District Court*, 334 U. S. 258, 263 (1948): "That power [to issue a writ of mandamus] protects the appellate jurisdiction which might be otherwise defeated * * *". See also *Roche* v. *Evaporated Milk Association*, 319 U. S. 21, 26 (1943).

As shown above and as recognized by the court below, the order of the District Court is beyond correction after final judgment in the main action and appellate jurisdiction would thus be thwarted if review is postponed until then.

On the basis of such circumstances, this Court in the case of *De Beers Consolidated Mines* v. *United States*, 325 U. S. 212 (1945), granted a common law writ of certiorari to review an interlocutory order of the District Court which restrained the defendants in an anti-trust suit from disposing of any of their property in the United States during the pendency of the action and until their compliance with any decree rendered against them. Mr. Justice Roberts, delivering the opinion of the court, said (at p. 217):

> "* * * no decision of the suit on the merits can redress any injury done by the order; and therefore unless it can be reviewed under §262 it can never be corrected if beyond the power of the court below."

This is precisely the situation here, if the order is held to be interlocutory in character.

Appellate jurisdiction may also properly be protected in the instant case by the issuance of a writ of mandamus.

As stated by this Court in *Ex parte Peru*, 318 U. S. 578, 583 (1943):

> "The historic use of writs of prohibition and mandamus directed by an appellate to an inferior court has been to exert the revisory appellate power over the inferior court. The writs thus afford an expeditious and effective means of confining the inferior court to a lawful exercise of its prescribed jurisdiction, *or of compelling it to exercise its authority when it is its duty to do so.*" (Italics added.)

Chapter 131 of the New Jersey Laws of 1945 gives to corporations an absolute right to require a stockholder owning less than the required number of shares to give security for counsel fees and expenses and an absolute right to have recourse thereto in the event that the plaintiff-stockholder is unsuccessful. As the Court of Appeals stated in its opinion, "* * * the wording of R. S. 14:3-15 leaves no discretion in the court below to require security of the plaintiff or the intervener. The only discretion conferred on the court by R. S. 14:3-15 is as to the *amount* of the security and of the subsequent reimbursement" (R. 59). In the instant case, the District Court refused to fix the security to be posted by the petitioners, which was its mandatory duty under the statute, and held that it was without jurisdiction to allow counsel fees and expenses. Under these circumstances, mandamus was a proper remedy to direct the District Court to exercise its jurisdiction and to fix the amount of security as required by the statute.

A case directly in point is *Ex parte United States*, 287 U. S. 241 (1932). There, the District Court had denied the government's petition for a bench warrant for the arrest

of a person duly indicted by the grand jury. This Court granted mandamus to review the order, saying (at p. 249):

> "The theory of the court below is that its denial of the petition of the government for a bench warrant was an exercise of its judicial discretion, and, therefore, not reviewable by mandamus. This view of the matter cannot be sustained. The question whether there was probable cause for putting the accused on trial was for the grand jury to determine, and the indictment being fair on its face, the court to which it was returned, upon the application of the United States attorney, should have issued the warrant as a matter of course."

Here, likewise, the District Court had no discretion in the matter, but should have ordered the posting of security by the plaintiff and intervener "as a matter of course", and its failure to do so, if not appealable, should have been corrected by the Court of Appeals in the exercise of the powers conferred upon it by 28 U. S. C. §1651(a).

It follows from the foregoing that the Court of Appeals for the Second Circuit erred when it held in *Aspinook Corp.* v. *Bright, supra,* that the matter here involved was not one in which mandamus should issue. We have already shown *supra,* at pp. 10-12, that the court fell into error because of its faulty analysis of the nature and effect of the statute. Thus, the court in the *Aspinook* case seems to have relied in part on *Ex parte Fahey,* 332 U. S. 258 (1947), in which this Court stated that a writ of mandamus, being an extraordinary remedy, should be resorted to only where appeal is a clearly inadequate remedy. This was not the case in *Ex parte Fahey,* which involved a petition for a writ of mandamus to review an order of the District Court *allowing* counsel fees, since the petitioner could obtain restitution if an appeal after final judgment resulted in a reversal of

the allowance. However, as shown above, in the *Aspinook* case and in the instant case a review after final judgment would be meaningless, and thus these cases constitute the very kind of "extraordinary cause" for which the extraordinary writs are intended.

The court's denial of the petition for mandamus was further based on the ground that it was not dealing with "a case of usurpation of power, [where] 'the lower court is clearly without jurisdiction,' instead of 'a mere error in the exercise of conceded judicial power' " (165 F. 2d, at p. 295). In making this statement, the court failed to recognize that the statute made it mandatory to require the posting of security and the decision of the District Court amounted to a refusal to exercise its jurisdiction in violation of the mandate of the statute. For the correction of such a refusal, mandamus is an appropriate remedy, if it should be held that the order is not reviewable immediately by appeal.

Thus, the reasons stated in the *per curiam* opinion in the *Aspinook* case do not support the decision of the court. Moreover, the court in that case had no doubt as to its power to issue the writ, but merely refused to exercise its discretion to do so. In the instant case, it is clear from the opinion of the court below that it would have granted the writ if it had held the order not to be appealable, provided only it had the power to do so. It is submitted that the court below had such power and that it would have been appropriate for it to exercise that power in the instant case, in the absence of the remedy by direct appeal.

III.

Chapter 131 of the New Jersey Laws of 1945 is binding on a Federal District Court sitting in New Jersey.

It is settled law, at least since this Court's decision in *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945), that in determining whether a state statute is binding on the federal courts under the Rules of Decision Act, 28 U. S. C. 1652, *infra*, p. 91, or the doctrine of *Erie R. R.* v. *Tompkins*, 304 U. S. 64 (1938), the answer will not depend on a technical classification of the statute as "substantive" or "procedural". As stated by Mr. Justice Frankfurter, speaking for the Court in the *Guaranty Trust Co.* case, at page 109:

> "*Erie R. Co.* v. *Tompkins* was not an endeavor to formulate scientific legal terminology. It expressed a policy that touches vitally the proper distribution of judicial power between State and federal courts."

If the statute creates a substantial right or embodies a public policy of the State, it will be enforced in the Federal Court, irrespective of how it may be classified for purposes other than the enforcement of the *Erie R. R.* v. *Tompkins* rule.

We shall show that the policy of the *Erie* case requires enforcement of the New Jersey statute by the District Court.

Moreover, even under a technical classification of the statute as "substantive" or "procedural", the result will be the same in any case. For, obviously, the statute must be either one or the other. If it is "substantive" in character, it must be enforced here under the Rules of Decision Act and the rule of *Erie R. R.* v. *Tompkins*. If it is

"procedural", we shall show that it must be enforced by the District Court under its own Local Rule 15.

1. Chapter 131 creates a substantial right and embodies an important public policy of the State of New Jersey which must be enforced by the Federal Court.

The only basis which the District Court had for assuming jurisdiction over this litigation is diversity of citizenship. The action does not involve any rights granted or duties imposed by federal law. It is an action involving solely state law. It is established that in such a case a federal court must, under the Rules of Decision Act (28 U. S. C. §1652) and under the Constitution itself, adjudicate all substantial rights as they would have been adjudicated by the state courts.

This principle was laid down in *Erie R. R.* v. *Tompkins*, 304 U. S. 64 (1938). Referring to the practice under the case of *Swift* v. *Tyson*, 16 Pet. 1 (U. S. 1842), which sanctioned different results in a litigation depending upon whether it was tried in a state or federal court, the Court said that the "mischievous results" of the doctrine had become apparent; that it made rights vary "according to whether enforcement was sought in the state or in the federal court"; that the privilege of "selecting the court in which the right should be determined was conferred upon the non-citizen"; and that the "doctrine rendered impossible equal protection of the law." The Federal Constitution required, said the Court, that "except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the state."

The case of *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945), made it clear that this constitutional doctrine requires that the law of the state to be applied by the federal

court includes *all* the law, whether it be called substantive or procedural, so long as it makes a substantial difference to the rights of the parties in the action. This Court said (p. 109):

> "And so the question is not whether a statute of limitations is deemed a matter of 'procedure' in some sense. The question is whether such a statute concerns merely the manner and the means by which a right to recover, as recognized by the State, is enforced, or whether such statutory limitation is a matter of substance in the aspect that alone is relevant to our problem, namely, does it significantly affect the result of a litigation for a federal court to disregard a law of a State that would be controlling in an action upon the same claim by the same parties in a State court?"
>
> "* * * In essence, the intent of that decision [Erie R. Co. v. Tompkins] was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court."

Thus, the only question is, does the statute here involved confer a substantial right on a corporation, or, phrased differently, would the refusal of the federal court to give effect to the statute leave all the parties in substantially the same position as if the action had been tried in the New Jersey state court?

If the protection of a corporation and its stockholders against heavy loss (which, as has been alleged without denial, will be at least $125,000) is not a substantial right, it is difficult to know what a substantial right means. Under the

imilar New York statute, plaintiffs have been required to ost security in very substantial amounts; e.g., security as fixed in the sum of $75,000 in *Tichner* v. *Andrews*, N. Y. . J., Feb. 26, 1948, p. 721, col. 2 (Sup. Ct., N. Y. Co.) and 100,000 in *Berger* v. *Ewing*, N. Y. L. J., Feb. 21, 1949, . 651, col. 1 (Sup. Ct, N. Y. Co.). If a federal court should efuse to apply this state statute, surely the outcome of a iven derivative stockholders' action in the federal court ould not be "substantially the same * * * as it would be if ied in a State court." In the state court, the corporation ould obtain reimbursement from the plaintiff through re- ourse to the security. In the federal court, on the other and, the corporation would stand the loss involved if the ate law is not applied.

A refusal to apply the state statute would produce to a arked degree the "mischievous results" that this Court ndemned in *Erie R. R.* v. *Tompkins*. It would make the ghts of stockholders and corporations vary according to hether derivative suits were brought in the state or in e federal court. It would inevitably cause plaintiffs to nploy objectionable manoeuvers to establish the requisite versity of citizenship and thus avoid the jurisdiction of ate court.

The recent case of *Angel* v. *Bullington*, 330 U. S. 183 947), well shows the broad scope of the doctrine of *Erie R. R.* v. *Tompkins* and establishes that a state statute is nding on the federal courts where it expresses a public olicy of the state, irrespective of whether that statute ay be labeled "procedural" or "substantive" for other rposes.

In that case, the plaintiff mortgagee had brought an tion in a North Carolina state court against the defend- t mortgagor for a deficiency judgment. Although the

plaintiff recovered judgment in the trial court, the Supreme Court of North Carolina reversed and dismissed the action, holding that it was barred by a North Carolina statute which provided that a mortgagee "shall not be entitled to a deficiency judgment." In upholding the constitutionality of the statute, the court stated it to be merely a limitation on the jurisdiction of the state courts, saying:

> "The statute operates upon the adjective law of the State, which pertains to the practice and procedure, or legal machinery by which the substantive law is made effective, and not upon the substantive law itself. It is a limitation of the jurisdiction of the courts of this State."

The plaintiff did not appeal this decision to this Court, but commenced a new action for a deficiency judgment in the Federal District Court for the Western District of North Carolina. He recovered judgment in the District Court, and this decision was affirmed by the Circuit Court of Appeals. This Court, however, reversed and held that the statute which deprived the state courts of jurisdiction, likewise precluded the federal courts from granting relief. The Court stated the principles of law which require the federal courts, in a diversity of citizenship case, to give effect to the public policy of the State as follows (at pp. 191-192):

> "It is suggested that the North Carolina Supreme Court construed the North Carolina statute to close only the North Carolina State courts but not the federal court sitting in North Carolina. In the first place, the North Carolina Supreme Court said no such thing. It construed the statute expressive of State policy and spoke only of the jurisdiction of the State courts because it was concerned only with the State courts. Secondly, it is most incongruous to attribute

> to the legislature and judiciary of North Carolina the imposition of a restriction against all its citizens from suing for a deficiency judgment, while impliedly authorizing citizens of other states to secure such deficiency judgments against North Carolinians. Thirdly, a North Carolina statute, upheld by the highest court of North Carolina, is of course expressive of North Carolina policy. The essence of diversity jurisdiction is that a federal court enforces State law and State policy. If North Carolina has authoritatively announced that deficiency judgments cannot be secured within its borders, it contradicts the presuppositions of diversity jurisdiction for a federal court in that State to give such a deficiency judgment. North Carolina would hardly allow defeat of a State-wide policy through occasional suits in a federal court. What is more important, diversity jurisdiction must follow State law and policy. A federal court in North Carolina, when invoked on grounds of diversity of citizenship, cannot give that which North Carolina has withheld. Availability of diversity jurisdiction which was put into the Constitution so as to prevent discrimination against outsiders is not to effect discrimination against the great body of local citizens."

It is clear that Chapter 131 of the New Jersey Laws of 1945 embodies an important public policy of that State. It is the result of a legislative finding that there was a specific evil to be corrected, namely, having corporations and their stockholders subjected to heavy losses as a result of unjustifiable litigation prosecuted by a holder of only a few shares of stock, having no real economic interest in the outcome of the litigation. In approving the legislation, the Governor pointed out that its purpose is

> "to deter the filing of irresponsible suits by persons who either have no legitimate cause of action or who

> institute such action more for the personal gain of a settlement out of court than in the interest of the corporation or its stockholders. These suits involving the highly complicated transactions of modern corporate business are very costly to defend, regardless of whether or not they may be justifiable. For this reason they have been the subject of great abuse and have been used to harass corporate officers and directors with baseless litigation. * * * It is a minimum protection for corporations and their officers and directors, against 'strike suits' * * *" (R. 45).

That a public policy of a state, expressed in a statute conferring upon a party to a litigation the right to be reimbursed for counsel fees, must be enforced by the federal courts, was decided by this Court ten years prior to its decision in *Erie R. R.* v. *Tompkins*. In *Sioux County* v. *National Surety Co.*, 276 U. S. 238 (1928), it was held that a Nebraska statute providing that in actions upon certain insurance policies the court "shall allow the plaintiff a reasonable sum as an attorney's fee in addition to the amount of his recovery, to be taxed as a part of the costs," must be applied by the federal courts. Brushing aside arguments based on the fact that the Supreme Court of Nebraska had held the statute procedural for one purpose, Mr. Justice Stone, speaking for the Court, said (at p. 243):

> "But the question before the Nebraska court in the cases cited was not that with which we are now concerned. Whether this liability for an attorney's fee, assumed by entering into an insurance contract after the enactment of the statute providing for the liability, may be enforced in the federal courts does not depend on any nice distinctions which may be taken between the right created and the remedy given. *Disregarding mere matters of form it is clear that it is the policy of the state to allow plaintiffs to*

recover an attorney's fee in certain cases, and it has made that policy effective by making the allowance of the fee mandatory on its courts in those cases. *It would be at least anomalous if this policy could be thwarted and the right so plainly given destroyed by removal of the cause to the federal courts.*" (Italics supplied.)

A decision in conflict with the principle of law relied on by the respondent is *Boyd* v. *Bell*, 64 F. Supp. 22 (S. D. N. Y. 1945). The court there held that section 61-b of the New York General Corporation Law, which is similar to the statute here involved, was procedural and that the federal court was not required to give effect to it.

It is clear that the decision of *Boyd* v. *Bell* is inconsistent with the decisions of this Court just discussed. Apparently, the *Sioux County* case was not called to the attention of the District Court. Moreover, an analysis of the decision discloses the erroneous basis on which it was reached.

In the first place, the whole basis upon which the court rested its finding that the statute was procedural is plainly unsound. The question was whether the right which the statute conferred on corporations was substantive or procedural under the doctrine of *Erie R. R.* v. *Tompkins*. But in deciding that the statute was procedural, the court gave no consideration whatever to the nature of the right conferred on corporations. If the court had analyzed the real issue involved, it seems clear that it would have held the statute to be substantive in nature, for how else was the right on the part of the corporation to be protected against losses up to and in excess of $100,000 to be classified?

In the second place, the court in *Boyd* v. *Bell* misapplied the doctrine of *Guaranty Trust Co.* v. *York*. Although it purported to apply the rule of *Guaranty Trust Co.* v. *York*,

it fell into the error of basing its decision solely on the proposition that the adjudication of the claims asserted against the individual defendants on behalf of the corporation would not be affected by the statute. In this connection the District Court said (at p. 24):

> "These cases all emphasize as substantive rules and law which clearly have a bearing upon the direction in which judgment will go, in the result of the litigation. Here section 61-b can have no such bearing. * * * Whether the security required was given, or not asked, the determination of the merits would not be in any way affected. Plaintiff would still be granted or denied relief depending upon the proof, and not upon compliance with the statute."

The quoted language makes it apparent that the District Court, in attempting to apply the test of the *York* case, considered merely the effect of the non-application of the statute on the individual defendants' liability, and completely ignored its effect on the *corporation's* rights. There is nothing in the decision of this Court in the *York* case which justifies such a position. We have shown, (*supra* pp. 13-16), that a motion under a statute like the one in issue involves a matter distinct from the general subject of litigation. Consequently, the proper inquiry, under the rule of the *York* case, is whether the non-application by the federal court of the state statute would "significantly affect the result" of the separate controversy between the plaintiff-stock-holder and the corporation and it is self-evident that it not only significantly "affects" the controversy but actually decides it.

Even looking at the main litigation, the rule of the *York* case that "the outcome of the litigation in the federal court should be substantially the same * * * as it would be if tried in a State court" would not be complied with, if

in the state court the unsuccessful plaintiff-stockholder must pay the counsel fees of the defendants, while in the federal court that burden falls upon the corporation.

Besides misconceiving the "substantially different result" test of the *York* case, the court in *Boyd* v. *Bell* completely ignored the fact that the statute expressed an important public policy of the state. It is clear under *Angel* v. *Bullington, supra*, which was decided after *Boyd* v. *Bell*, that the District Court for the Southern District of New York erred in failing to give effect to the New York State public policy, irrespective of whether the statute is classified as "procedural" or "substantive".

In light of the decision in *Angel* v. *Bullington*, a contrary result was reached in *Donovan* v. *Queensboro Corp.*, 75 F. Supp. 131 (E. D. N. Y. 1947), appeal dismissed March 23, 1948 (2d Cir., unreported), cert. denied 335 U. S. 804 (1948), where the court granted a motion by a corporation to compel the plaintiff to furnish security in the sum of $50,000, holding that Section 61-b of the New York General Corporation Law must be given effect in the federal court. Dealing with the argument that the statute was merely a procedural matter, the court said (at p. 133):

> "Apparently in regard to the argument that this statute is merely a procedural matter, the Court of Appeals of the State of New York (opinion of Judge Lehman, Ch. J.), Shielcrawt *v.* Moffett, 294 N. Y. 180, decided at page 190: 'The statute we are considering differs from such purely procedural statutes both in purpose and effect.' The opinion then goes on to express an important difference. It plainly indicates a definite policy for the protection of defendant residents of the state and, 'creates a remedy for a wrong for which previously there was no remedy.'
>
> . . . . . .

> "Recently it has been plainly indicated by the Supreme Court of the United States that discrimination against citizens of a State should be avoided, where possible, in the use of diversity of citizenship actions. I refer for this principle, although the facts in that case are different, to the case of Angel *v.* Bullington, 330 U. S. 183, (decided February 17, 1947); Mr. Justice Frankfurter writing for the court states: 'What is more important, diversity jurisdiction must follow State law and policy. A federal court in North Carolina, when invoked on grounds of diversity of citizenship, cannot give that which North Carolina has withheld'."

Thus, in enforcing the state statute, the court in the *Donovan* case relied on *Shielcrawt* v. *Moffett* and *Angel* v. *Bullington*. It is important to note that in *Boyd* v. *Bell*, *supra*, Judge Bright did not even refer to *Shielcrawt* v. *Moffett* and that *Angel* v. *Bullington* had not then been decided by this Court.

There can thus be no doubt that under *Sioux County* v. *National Surety Co.*, *Erie R. R.* v. *Tompkins*, *Guaranty Trust Co.* v. *York* and *Angel* v. *Bullington*, *supra*, the New Jersey statute must be enforced by a federal district court sitting in New Jersey.

On the basis of the foregoing considerations, Professor Moore states with respect to this question (3 *Federal Practice* (2d ed. 1948) 3505) that

> "To pursue the theory that federal courts can handle stockholder-corporate litigation more justly, if they are free of the statute, than their sister state courts across the street, who are fettered by the 'unwise' statutory policy, takes us back to the days of *Swift* v. *Tyson*."

The petitioners' arguments to the contrary are invalid.

In the first place, petitioners argue that the order of the District Court was merely concerned with the "procedural" matter of furnishing security and had nothing to do with any right of the respondent to be reimbursed for expenses. As shown above, page 4, this argument is fallacious. For under the statute, the denial of "security" at the same time denies any right to reimbursement for the expenses in question. The petitioners misconceive the nature of the statute when they assert that the posting of security and the creation of the right of reimbursement are "two distinct questions." The right to reimbursement is limited to, and created by, the security which is posted. The denial of security is a denial at the same time of right to reimbursement which is limited to "recourse" against such security.

In the second place, the petitioners' argument that Rule 23(c) of the Federal Rules of Civil Procedure prevents the application of the New Jersey statute is without merit. Rule 23(c) is entirely different from Chapter 131; it deals solely with the mechanics for the *settlement* of a derivative action. It does not give a corporation any right whatever to obtain reimbursement for expenses to which it may be subjected as a result of an unmeritorious derivative action. Rule 23 does not deal with that subject at all. Chapter 131 is thus in no way inconsistent with Rule 23. Carried to its logical conclusion, the petitioners' position would lead to the result that all state law relating to derivative stockholders' suits has been superseded by Rule 23 in the federal courts.

Moreover, in no event would the existence of Rule 23 have any materiality to the question here involved. The question is whether the New Jersey statute is of the kind which must be enforced in a federal court by reason of the constitutional distribution of federal and state powers. If

it is, no federal statute or rule can be invoked to supersede or eliminate the state statute.

2. Even if the statute is held to be procedural in nature, it must be enforced by the District Court under its own Local Rule 15.

Even if Chapter 131 did not create a substantial right and did not embody an important public policy of the State, it would still have to be enforced under the District Court's Local Rule 15, which provides as follows:

> "*Applicability of State Court Procedure.* In circumstances not provided for by the Federal Rules of Civil Procedure, or by these rules, the procedure and practice of the Courts of the State of New Jersey shall govern."

It is clear that the security for expenses and counsel fees required under Chapter 131 of the New Jersey Laws of 1945 is a circumstance not provided for by the Federal Rules of Civil Procedure. It is likewise not provided for by the Rules of the District Court. While the latter Rules make provision, in Rule 12, for security for costs, that Rule relates only to security for costs required of non-residents, and, morever, contemplates security for ordinary costs only, whereas it is well settled in the Federal Courts that the expenses and counsel fees referred to in Chapter 131 are not "costs".

Missouri State Life Insurance Co. v. *Jones,* 290 U. S. 199 (1933);
Springstead v. *Crawfordsville State Bank,* 231 U. S. 541 (1913).

The law is well established that rules of court, unless directory and merely for the protection of the court, have the force of law and a federal court has no power to suspend

or modify retroactively any rule which it has made. Thus, it was held in *Rio Grande Irrigation and Colonization Co.* v. *Gildersleeve*, 174 U. S. 603 (1899), that a court rule fixing the time limit for motions to set aside a judgment rendered in vacation could not be dispensed with by the trial court. This Court quoted with approval the following passage from *Thompson v. Hatch*, 3 Pick. 512 (Mass., 1827):

> "A rule of the court, thus authorized and made has the force of law, and is binding upon the court as well as upon parties to an action, and cannot be dispensed with to suit the circumstances of any particular case * * *. The courts may rescind or repeal their rules, without doubt; or, in establishing them, may reserve the exercise of discretion for particular cases. But the rule once made without any such qualification must be applied to all cases which come within it, until it is repealed by the authority which made it."

Accord:

Weil v. *Neary*, 278 U. S. 160 (1929);
Hicks v. *Bekins Moving & Storage Co.*, 115 F. 2d 406 (9th Cir. 1940);
Wise v. *Herzog*, 114 F. 2d 486, 490 (D. C. Cir. 1940);
In re G. W. Giannini, Inc., 90 F. 2d 445 (2d Cir. 1937);
Superior Fire Insurance Co. v. *Martin*, 80 F. 2d 275 (7th Cir. 1935), cert. denied 298 U. S. 672 (1936);
In re Growe Construction Co., 253 Fed. 981 (N. D. N. Y. 1918).

Cases dealing with a question very similar to the one here before the Court have been decided in the Eastern

District of New York. Local Civil Rule 45 of the Eastern District of New York, *infra*, p. 93, provides in substance that in the absence of Federal law the District Court shall apply the procedure prevailing in the New York state courts. Since the United States District Court for the Eastern District of New York does not have a local rule dealing with security for costs required of non-residents, it has held that Local Civil Rule 45 requires the application of the state law governing such security.

> *De Rosmo* v. *Feeney*, 38 F. Supp. 834 (E. D. N. Y. 1941).

And under Local Civil Rule 45 so construed, the District Court for the Eastern District of New York has further held that the granting of an order for security for costs is mandatory and not discretionary.

> *Janssen* v. *City of New York*, 42 F. Supp. 380 (E. D. N. Y. 1941).

Finally, in *Donovan* v. *Queensboro Corp., supra*, the court, in applying the state statute under the doctrine of *Angel* v. *Bullington*, recognized that in any event it would have to be given effect under Local Rule 45, saying (75 F. Supp. at p. 133):

> "Moreover, Rule 45 of this Federal District Court provides that, 'whenever a procedural question arises which is not covered by the provision of any statute of the United States or of the Federal Rules of Civil Procedure * * * the procedure which shall then prevail in the Supreme Court of the State of New York shall be applied.'"

It should be pointed out that the District Court for the Southern District of New York, which decided the case of

Boyd v. *Bell*, does not have any local rule making it *mandatory* to apply the state procedure, as is required by Rule 15 of the District Court for the District of New Jersey.

It follows that Rule 15 of the Rules of the District Court governs and requires the application of the provisions of Chapter 131, if that statute is held to be "procedural" under the rule of *Erie R. R.* v. *Tompkins*.

IV.

There is no substance to the contention that the statute is unconstitutional.

Petitioners attack the New Jersey statute as violating the due process, equal protection, contract and full faith and credit clauses of the Constitution.

What concretely is the nature of petitioners' right to which the statute applies? Petitioners, representing less than 0.0126% of the stock of the respondent corporation, are prosecuting an action for the alleged benefit, not of themselves, but of the respondent. If the action is unmeritorious, the respondent will be subjected to damage estimated to be at least $125,000; and there is absolutely no means by which the holders of the other 99.9% of its stock could make their judgment as to whether the bringing of the action was in the best interests of the corporation prevail over the ideas of petitioners holding less than 0.0126% of its stock.

However, it is said, perhaps petitioners will recover a substantial judgment and benefit the respondent and the holders of the other 99.9% of its stock. But the fundamental question here is whether it is a principle of constitutional law that the holders of 99.9% of the stock and their corporate management are *compelled;* contrary to the

policy of a State Legislature, to rely upon the responsibility and judgment of the holders of 0.0126% of the stock. In that connection, petitioners did not hesitate to plead causes of action alleging liability of over $90,000,000 which were so completely lacking in substance that they were stricken by the District Court as being insufficient even under the liberal rules of Federal pleading, but not before petitioners had caused substantial expense which must eventually be borne by respondent. See *Cohen* v. *Beneficial Industrial Loan Corporation*, 69 F. Supp. 297 (D. N. J. 1946).

Perhaps a better statute could have been drafted by the New Jersey Legislature to cope with the evil found (and admitted) to exist. There is no perfect solution for the problem involved. There never is in balancing a network of complicated relationships in modern corporate enterprise. Possibly giving the holders of an infinitesimal percentage of the stock of a corporation, instead of the minimum interest required by the statute, a free hand to prosecute derivative actions might make the difference as to whether some faithless officers are brought up to account. Perhaps some legislative changes are needed in the light of modern conditions to make corporate management more responsive to the will of the majority of the stockholders. But the question is whether the problems involved are matters coming within the area for legislative action or the area for judicial control under the Constitution.

We submit that the New Jersey statute must be upheld under the principle which this Court has consistently applied, namely, it is sufficient if the statute has a rational relation to the evil found by the Legislature to exist, that the forum for a consideration whether the statute be ill-considered or unwise is the Legislature which adopted it, and every possible presumption will be made in favor

of the validity of the legislative action. Thus, in *Daniel v. Family Security Life Insurance Co.*, 69 Sup. Ct. 550, 553 (1949), this Court said in upholding a South Carolina statute outlawing so-called funeral insurance:

> "We cannot say that South Carolina is not entitled to call the funeral insurance business an evil. *Nor can we say that the statute has no relation to the elimination of those evils.* There our inquiry must stop." (Italics supplied.)

Similarly, in *Zahn v. Board of Public Works*, 274 U. S. 325, 328 (1927), this Court said:

> "The most that can be said is that whether that determination was an unreasonable, arbitrary or unequal exercise of power is fairly debatable. In such circumstances, the settled rule of this court is that it will not substitute its judgment for that of the legislative body charged with the primary duty and responsibility of determining the question."

In *Olsen v. Nebraska*, 313 U. S. 236 (1941), this Court upheld a state statute fixing the maximum compensation which a private employment agency might collect from an applicant for employment. This Court rejected the argument that the statute was unconstitutional because there had been no showing that there were conditions which the Legislature might reasonably believe would injure the public unless corrected by such legislation, saying (p. 246):

> "We are not concerned, however, with the wisdom, need, or appropriateness of the legislation. Differences of opinion on that score suggest a choice which 'should be left where * * * it was left by the Constitution—to the States and to Congress.' * * * There is no necessity for the state to demonstrate before us that evils persist despite the competition which attends the bargaining in this field."

In sustaining the constitutionality of a New York statute attacked as violating the due process clause, this Court said in *Nebbia* v. *New York*, 291 U. S. 502, 538 (1934), that

> "every possible presumption is in favor of its validity * * *."

When the above principles are applied to the New Jersey statute, it is apparent that there is no substance whatever to the contention that it is unconstitutional; and that the proper forum for the petitioners to present their criticism is the New Jersey Legislature.

Thus, the Legislature and Governor of New Jersey expressly found that a substantial evil existed which called for correction. In adopting Chapter 131, the New Jersey Legislature found that the prosecution of stockholders' derivative actions *"has been the subject of great abuse and malodorous scandal"* (R. S. Cum. Supp. 1945/1947, p. 824). (Italics ours.) In approving the statute in question, the Governor of New Jersey pointed out that

> "These suits involving the highly complicated transactions of modern corporate business are very costly to defend, regardless of whether or not they may be justifiable. For this reason they have been the subject of great abuse and have been used to harass corporate officers and directors with baseless litigation. * * * It is a minimum protection for corporations, and their officers and directors, against 'strike suits' * * * " (R. 45).

Further, by adopting the statute, the Legislature and Governor of New Jersey found that the remedy selected was appropriately related to the correction of the evil found to exist. The extent of the evil which was involved and the relationship of the statute to the correction of that evil is well indicated by the fact that four other states have passed

similar statutes, New York (General Corporation Law, § 61-b), Pennsylvania (Pa. Stat. Ann. (Purdon, Supp. 1945) Tit. 12, § 1322), Maryland (Md. Laws, 1945, ch. 989) and Wisconsin (Wis. Stat. (1945) § 180.13). This Court in *Daniel* v. *Family Security Life Insurance Co., supra,* recognized the fact that the enactment of similar statutes by different states showed that there must be some reasonable basis for the type of statute adopted. In upholding the South Carolina statute, this Court said (69 Sup. Ct. at p. 552):

> "The South Carolina legislature is not alone in seeing evils in this kind of insurance, and in invoking its police powers to combat them." [Reference to the laws of New York, Florida, Ohio and Maryland omitted.]

It was upon the basis of the above principles that the New York Court of Appeals upheld the constitutionality of the New York statute, substantially identical with the New Jersey statute here involved, in *Lapchak* v. *Baker,* 298 N. Y. 89, 95, 80 N. E. 2d 751, 753 (1948), saying:

> "The existence of some of these evils is here conceded. Moreover, the Legislature, *as we must assume,* inquired and found (1) justification for making special provision in respect of derivative suits brought by holders of relatively small amounts of a corporation's stock and (2) occasion for requiring plaintiffs in such suits to give reasonable security for litigation expenses of defendants therein. [Citations omitted.] Of course, it is not for us to question the wisdom of the choice of remedy here adopted by the Legislature." (Italics supplied.)

The briefs submitted to the New York Court of Appeals in that case to support the claim of unconstitutionality

contained the same arguments, almost verbatim, as are contained in the briefs submitted to this Court in support of petitioners' position; and they were all rejected.

In the light of the above principles, it becomes apparent why the New York Court of Appeals unanimously rejected such arguments on the basic ground that the criticisms involved were a matter for legislative and not judicial consideration. However, we shall now proceed to discuss the alleged application of each of the clauses of the Constitution invoked by the petitioners.

We will show (A) the statute does not violate the due process clause, (B) the statute does not violate the equal protection clause, (C) the application of the statute to actions pending at the time of its enactment does not violate either the contract or due process clause, and (D) the statute does not violate the full faith and credit clause.

A.

The Statute Does Not Violate the Due Process Clause.

The petitioners contend in substance that (1) the due process clause guarantees to a stockholder a right to prosecute a derivative action and (2) the statute deprives petitioners of such right without due process of law. We will deal with these contentions in the same order.

1. The due process clause does not guarantee to a stock holder a right to prosecute a derivative action.

This is so because of two reasons: (a) The right to bring a derivative action is not property within the meaning of the due process clause, and (b) even if it were property, the right to prosecute an action may be barred under the police power of a state.

(a)

While we shall show below under sub-point 2, pages 49-63, that, even if a right to prosecute a derivative action were a property right, the statute clearly does not take away that right without due process of law, we shall show here that it is not a property right within the meaning of the due process clause.

The petitioners' position is predicated upon the fallacious assumption that the right of a stockholder to prosecute a derivative action is the same as the right of a plaintiff to prosecute a cause of action which is his own property. Thus, in asserting an unconstitutional denial of access to the courts, petitioners rely exclusively upon cases dealing with a party enforcing his *own* cause of action and his *own* property rights.

However, it is well established that a stockholder in a derivative action is prosecuting not his own cause of action but that of the corporation; and that such cause of action is the property of the corporation and not the property of the plaintiff stockholder. The applicable law was expressed as follows by the court below (R. 58):

> "The right to bring a stockholder's derivative suit is not a property right and as this court held in Overfield v. Penroad Corporation, 146 F. 2d 889, 894 . . . the individual stockholder is permitted to sue 'simply in order to set in motion the judicial machinery of the court.'"

It is a basic principle of the law of corporations that stockholders have no property right in the assets of their corporation. As stated by Mr. Justice Holmes in *Klein* v. *Board of Supervisors*, 282 U. S. 19, 24 (1930):

> "But it leads nowhere to call a corporation a fiction. If it is a fiction it is a fiction created by law with in-

tent that it should be acted on as if true. *The corporation is a person and its ownership is a nonconductor that makes it impossible to attribute an interest in its property to its members.*" (Italics ours.)

This Court said in *Koster* v. *Lumbermens Mutual Casualty Co.*, 330 U. S. 518, 522 (1947):

> "The cause of action which such a plaintiff brings before the court is not his own but the corporation's. It is the real party in interest and he is allowed to act in protection of its interest somewhat as a 'next friend' might do for an individual, because it is disabled from protecting itself."

In the recent case of *Myer* v. *Myer*, 271 App. Div. 465, 473, 66 N. Y. S. 2d 83, 91 (1st Dept. 1946), aff'd 296 N. Y. 979, 73 N. E. 2d 562 (1947), the rule is stated as follows:

> "A stockholder has no right to institute action in his own behalf, but only on behalf of the corporation.
>
> * * * * * *
>
> "The right that the plaintiffs have * * * to sue in the name of and for the benefit of the corporation * * *, is a contingent right of action only. Insofar as it may be of benefit to the stockholder personally the property right is a remote and insubstantial one * * *. *Under these circumstances we do not deem the right is one that may demand protection against legislative regulation* * * *. The situation might be different if the stockholder had a right of personal recovery against the officers and directors and was prevented from pursuing his remedies as a creditor as to some accrued claim. * * *
>
> "Here the corporation was the creditor and its rights remained unabridged." (Italics ours.)

The New Jersey Court of Chancery in *Goodbody* v. *Delaney*, 80 N. J. Eq. 417, 419, 83 Atl. 988, 989 (Ch. 1912), has expressed the same view as follows:

> "The stockholders do not sue in their own right, but in the right of the corporation, and the use of the names of stockholders as complainants is mere procedure and belongs not to the substantive law of the case, but to the pursuit of the remedy in favor of the corporation."

Despite the well established law referred to above, petitioners would have the constitutional issues which they tender in this case decided just as if the cause of action prosecuted by a plaintiff in a derivative action were his own property. In this connection, they assert that a derivative action represents a stockholder's "only effective remedy against corporate abuse" and that nothing turns on the technical name which is given to the nature of the remedy involved.

However, such fundamental distinctions as to who really owns a cause of action and whose property is really involved cannot be so lightly brushed aside, especially when the basic problem is to distinguish between the area for legislative action on the one hand and the area for constitutional restrictions on the other. So far as this problem is concerned, what then is the important difference between a plaintiff prosecuting his own cause of action and a stockholder prosecuting an action owned by his corporation? In the first case, the plaintiff is acting solely on his own behalf, and in the second case the stockholder is acting on the behalf of the corporation and the vast majority of the other stockholders and without their consent or approval. In the first case, it is only the property of the plaintiff that is involved, and, in the second case it is the property of the corporation as a

whole and the interest which *all* of its stockholders have therein that is involved.

It thus follows that since the New Jersey statute deals with the property rights of the corporation as a whole, the only constitutional issue which could be involved is whether the New Jersey statute has deprived *corporations* of their property in an arbitrary or unreasonable manner. To state the real issue involved is to disclose the obvious answer. For very good reasons, petitioners do not seriously contend that the statute has arbitrarily and unreasonably deprived the *corporation* of property. For once it is observed that such is the basic problem, it becomes apparent that a legislative and not a judicial field is involved.

(b)

Moreover, even if a cause of action *owned* by a stockholder were involved (which as shown above is not the case) and even if the New Jersey statute had unconditionally barred such an action (which it has not), the due process clause would not, merely for those reasons, make the action of the New Jersey Legislature invalid. A state may prohibit the prosecution of such an action in its courts, provided such prohibition has a reasonable relation to a public evil and does not involve any unreasonable classifications.

Thus, in *Pittsburg Steel Co.* v. *Baltimore Equitable Society*, 226 U. S. 455 (1913), this Court upheld the constitutionality of a state statute outlawing the pre-existing right of one creditor of a corporation to recover against stockholders on their subscription obligations to the corporation. In *Battaglia* v. *General Motors Corp.*, 169 F. 2d 254 (2 Cir. 1948), cert. denied 335 U. S. 887 (1948), a statute outlawing the pre-existing right of an employee to maintain a so-called portal-to-portal action to recover

compensation was upheld. In *Veix* v. *Sixth Ward Association*, 310 U. S. 32 (1940), a state statute outlawing a pre-existing right of a shareholder in a New Jersey building and loan association to recover his investment upon 30 days' notice was upheld. In *Gelfert* v. *National City Bank of New York*, 313 U. S. 221 (1941), this Court upheld a state statute outlawing a pre-existing right of a mortgagee to recover a deficiency judgment equal to the difference between the amount of the debt and the amount for which the mortgagee bought in the property at a foreclosure sale.

2. In no event does the statute deprive a stockholder of any right without due process of law.

The statute does not prohibit the prosecution of derivative actions, but merely subjects the prosecution of such actions to reasonable conditions which represent a remedy that has a reasonable relation to the evil found to exist.

It is clear that (a) New Jersey provided a remedy for a serious evil where no remedy existed before; (b) the particular remedy selected by the Legislature had a reasonable relationship to the correction of the evil; and (c) the statute merely made the prosecution of derivative actions subject to reasonable conditions.

(a)

New Jersey Provided a Remedy for a Serious Evil Where No Remedy Existed Before.

As we have pointed out above, the petitioners would overlook the anomalous legal situation which resulted from the uncontrolled prosecution of stockholders' derivative actions because of a fallacious assumption that they are comparable to an ordinary litigation in which the plain-

tiff and defendant are concerned solely with their own individual rights and duties.

As distinguished from an ordinary litigation, in a stockholder's derivative action the rights and interests of third parties are involved. The extent to which the plaintiff's own individual rights are *indirectly* involved represents only an insignificant fraction of the total rights which are *directly* involved.

When a plaintiff in a normal litigation brings an action, he subjects no one to a risk of loss other than himself and the defendant from whom he seeks recovery. In sharp contrast, when a stockholder institutes a derivative action, he subjects third parties (whose interests far outweigh the interest of the plaintiff stockholder and who are charged with no wrong-doing) to a risk of loss. The nature of the evil involved has been stated as follows in the *Survey and Report regarding Stockholders' Derivative Suits* by Franklin S. Wood (pp. 20-21):

> "To permit a stockholder with a few shares of stock to institute such a derivative action ostensibly in behalf of the corporation but actually in the interest of his attorney, since the latter alone stands to profit in any substantial degree from it, without any responsibility for costs of the action if shown to be unfounded is, to paraphrase Judge Rosenman's language in a bondholders' action for an accounting, tantamount to allowing him and his attorney to gamble with other peoples' money. Section 130-f of the Real Property Law, enacted in 1936, no longer permits such a free gamble by a bondholder and it would seem that less excuse can be found for permitting it in the case of a stockholder, whose initial investment and interest in the outcome are frequently much less than that of a bondholder."

Even if there were no record of experience by which to measure the extent of the evil involved, the probability of abuse in the uncontrolled prosecution of derivative actions would be indicated by a fair answer to the question: What motivation does a stockholder have in prosecuting a long-drawn out and expensive corporate litigation when his economic interest in the outcome of the litigation represents only a few dollars?

It is incredible that in the great majority of cases the plaintiff is motivated by a consideration of the effect of the litigation on the welfare of the corporation.

It is not necessary, however, to rely merely upon logic, for experience has shown the extent to which the prosecution of this type of action has been abused and the extent to which corporations have been injured thereby.

Some of the abuses connected with the prosecution of derivative stockholders' suits have recently been described by Richard F. Wolfson, a member of the law firm of Kurland & Wolfson, New York City, and a partner of petitioners' counsel here, in an article entitled "Striking out 'strike suits'" in the March, 1949 issue of "Fortune," as follows (at p. 138):

> "The latter [abuses other than blackmail] may, indeed, be inherent in derivative stockholder suits. They arise chiefly from the fact that lawyers, not plaintiffs, are financially interested in bringing derivative actions. For example, in a stockholder action brought on behalf of Paramount Pictures, one plaintiff stood to gain only 17 cents per share by appreciation of the value of his stock. Such a plaintiff is unlikely to ask a lawyer to institute on his behalf an expensive, time-consuming suit. Even less likely is he to pay the costs.

"But the lawyer may get a sizable fee because derivative stockholder actions work on a contingent principle * * *

* * * * * * *

"* * * This disparity between the plaintiff's and his lawyer's interest has led to a species of what lawyers quaintly call 'champerty and maintenance.' A lawyer discovers a derivative cause of action, solicits a stockholder as client, pays expenses, and, for the use of his name, offers the client a small share of any fees recovered. For many lawyers the search for clients is no haphazard affair; and arrangement is made with a broker to furnish them.

* * * * * * * *

"Another unfortunate product of stockholder actions is the waste of time and money involved in unsuccessful ones. Because such suits often involve difficult and novel questions of corporation law and intricate factual situations, months or years are spent in court. Expenses mount, as do attorneys' fees of individual defendants. If the suit fails, the expenses and fees are generally borne by the corporation, as ordered by the bylaws."

In an article entitled "Directors Who Do Not Direct", 47 Harv. L. Rev. 1305 (1934), Professor (now Mr. Justice) William O. Douglas said (at p. 1327):

"The enforcement of these obligations of trusteeship has two aspects. In the first place, there is the small and isolated investor who needs adequate opportunity for protection against the managers or the board. In the second place, there are the managers and the board who need effective protection against the blackmailer or striker, lest the risks attendant to those business positions prove to be too onerous. Making it easier for the legitimate plaintiff and harder for the illegitimate is a problem which will

never be wholly solved, but some progress can be made. In one form or other it means granting to trial courts greater discretion. * * * *And it certainly would embrace a reconsideration of the control over costs or security for costs.*" (Italics added).

The following is a typical comment by the courts:

In *Gazan* v. *Vadsco Sales Corporation*, 6 F. Supp. 568 (E. D. N. Y. 1934), the court said:

> "The plaintiff testified that he had never read the complaint, did not know what it contained; and was unaware of the charges made over his name in the complaint against the defendant corporation; that he had not contributed to the expenses of the litigation; that he did not know of any of the information that was contained in the complaint, nor did he give such information to the plaintiff's attorney, nor did he know in what manner his counsel obtained the information for the purposes of preparing the complaint.
>
> "Apparently the plaintiff gave the use of his name to others for the purpose of instituting this action. This action was brought without any basis, and was vexatious and oppressive. It was brought solely for the purpose of annoying and harassing the defendant corporation and its business."

The seriousness of the damage inflicted upon corporations as a consequence of unsuccessful stockholders' actions is discussed as follows in Wood, *Survey and Report Regarding Stockholders' Derivative Suits* (1944) 8:

> "Cost of Stockholder Litigation to Public:
>
> * * * * * *
>
> "The direct cost of defense to the corporations involved has also been substantial. Since many defendants are usually involved, numerous separate

defense counsel are often necessarily employed, the tabulated cases showing 296 actions in which three or more defense counsel appeared. Allowances to attorneys for individual defendants under §61-a of the General Corporation Law in twelve recent actions, ranging from $4,000 to $135,000 are given below, and judgments of dismissal in two other cases currently on appeal provide for such allowances. These are exclusive of fees paid counsel for the corporations involved, of which there is no court record, although in two reported instances such fees exceeded $100,000 (*Kirby* v. *Schenck*, 25 N. Y. S. 2d 431; *Heller* v. *Boylan*, 29 N. Y. S. 2d 653)."

(b)

The Particular Remedy Selected by the Legislature had a Reasonable Relation to the Correction of the Evil.

The weakness of the claim that the remedy adopted by the Legislature has no rational relation to the evil involved is well indicated by the fact that the briefs submitted in support of that claim resort to an attack on the motives of the Legislatures of New Jersey and New York.

Instead of according to the State Legislatures "every possible presumption" in favor of their action, and asking the question as to whether there was any reasonable basis on which the Legislature could have adopted the remedy involved, the petitioners would reverse the process and require the Legislature to prove that there could be no reasonable basis on which anyone could have opposed the legislation in question.

Let us consider the question involved in the light of the correct principle of constitutional law, namely, is there any reasonable basis, in the light of the evil involved, on which the Legislature could have selected the remedy which it did select.

The Legislature did not prohibit the prosecution of derivative actions which, as above shown, it could have constitutionally done; instead it permitted the continued prosecution of such actions, provided not merely one but any one of three conditions were met.

In the first place, if a stockholder could enlist the support of the holders of 5% of the outstanding stock of a corporation, a derivative action could be instituted without any restrictions and without the necessity of putting up security. This still permitted 5% of the stockholders to override the judgment of 95% with respect to the wisdom of corporate litigation. But the Legislature recognized that in large corporations, with their stock widely held, a substantial burden (but not unreasonable in the light of the evil involved) would be placed on a small stockholder to enlist the necessary support, and so

In the second place, the Legislature provided that if a stockholder could enlist the support of the holders of stock which had a market value of $50,000, a derivative action could be instituted without any restriction and without the necessity of putting up security. Under this alternative, as the corporation gets larger the percentage of the stock ownership required gets smaller. For example, in the case of a corporation whose outstanding stock has a market value of $50,000,000, a derivative action can be prosecuted without restriction by holders of only 1/10 of 1% of the stock. And the attack on the statute is directed to its impact on a stockholder in the large corporations with their stock widely held by the general public.

However, petitioners assert that even this relaxation of the statutory requirements, embodied in the second alternative, is unreasonable. The question is whether requiring a small stockholder to enlist the support of holders of

1/10 of 1% or 1% and so on of the corporation's stock, depending upon the size of the corporation, imposes an arbitrary burden which has no rational relation to the evil involved.

No doubt the requirement would increase the burden of instituting a derivative action. But it is an unsupportable assertion to say that it is unreasonable. Generally, of course, it is the lawyer who in the first instance enlists the support of a small stockholder. The method that he uses in enlisting the support of one small stockholder is the same method by which he can enlist the support of a few more stockholders. In that connection access can be obtained to the stock books of the corporation and in these large corporations with their stock widely held it is more than probable that numerous other small stockholders will reside within a distance making it inexpensive to have a personal discussion with regard to the merits of the action which is desired to be instituted.

Moreover, in the case of large publicly owned corporations with which petitioners are concerned, a stockholder is permitted under the regulations promulgated under the Securities Exchange Act of 1934 to require the corporation to print and circularize in its proxy statement without expense to him proposals which he desires to submit to the stockholders. See Regulation X-14, Rule X-14A-8.

The petitioners assert that fewer derivative actions have been instituted since the adoption of the statute, but for all the petitioners can show this is due to the fact that it is difficult to find more than one or two persons in each corporation who is willing to lend his name to questionable litigation.

It is said that prior to the enactment of these statutes some meritorious actions were instituted by a stockholder

holding only a few shares of stock; and that these meritorious actions will be struck down by the statutes along with the groundless and abusive litigations. That again is an unsupportable assertion. Before the enactment of these statutes it was unnecessary for a stockholder owning only a few shares of stock to persuade additional stockholders to join as plaintiffs; and hence there is no basis for saying that if they had made such an effort with respect to *meritorious* litigations they would have failed. It is unreasonable to assume that there is only one stockholder in each corporation owning a few shares who alone occupies the unique position of being able to recognize the need for the prosecution of a meritorious action. It is unreasonable to assume that there is only *one* of such stockholders who has a unique access to the facts to enable a determination as to whether or not a meritorious claim exists. And the second, third and fourth stockholders would have no greater risk to assume than the first stockholder, which is absolutely nothing, provided the attorney takes the case on a contingent basis, which is the usual practice. The fact of the matter is that in the past lawyers have not desired to inform other stockholders of a proposed derivative action in order to eliminate the risk of having to share the eventual fee with other lawyers.

Finally, it should be pointed out that Rule 23(b) of the Federal Rules of Civil Procedure requires a stockholder, before instituting a derivative action, to present the facts to not merely a very small percentage of the stockholders, but the majority of the stockholders, unless he can affirmatively show special circumstances which would make such a presentation futile. It has been held that difficulties in communicating with the stockholders do not excuse compliance with this requirement. *Stone* v. *Holly Hill Fruit Products*, 56 F. 2d 553, 554 (5th Cir. 1932); *Toebelman* v. *Missouri-Kansas Pipe Line Co.*, 41 F. Supp. 231, 239 (D. Del. 1941)

Petitioners make the extraordinary suggestion (on p. 27 of their brief) that the Legislatures which enacted these statutes were not really interested in giving a stockholder a right to qualify to prosecute a derivative action by enlisting the support of additional stockholders. They do this on the basis of an assertion that certain New York cases have held that "the joinder, *after* an action has been commenced, by plaintiffs owning at least the minimum amount of stock required by the statute does not obviate the necessity for the security . . ." (Italics ours.) In fact, these cases (cited on p. 28 of petitioners' brief) hold the contrary. They decided that a stockholder might qualify by enlisting the support of other stockholders even after the commencement of the action.

In the third place, if and only if a stockholder cannot qualify under either of the two alternatives referred to above, is he required to put up security to protect the corporation and the vast majority of its stockholders against loss. He is required to put up security in a reasonable amount; and it is left to the trial court in each instance to determine in its discretion what is a reasonable amount. There is of course no doubt that the requirement for security has a relation to the evil involved, for it goes to the essence of protecting corporations and their stockholders against the type of losses to which the Legislature has found they have been subjected. But the petitioners protest that the smaller stockholder will be unable or unwilling to put up the security. This may be true; but the statute could not possibly become more restrictive on the right of a small stockholder to prosecute a derivative action because he is given an additional, i. e., a third, alternative basis for qualifying to prosecute a derivative action. And how can it be claimed that it was unreasonable for a Legislature to prevent the institution of litigation involving the whole cor-

poration, unless 1/10 of 1% or 1% or a maximum of 5% of the stockholders determine that such litigation should be instituted.

If the Legislature had any right to require certain conditions to be met as a safeguard against the prosecution of abusive derivative actions (and it obviously did), *any* safeguards which it adopted that had any meaning would necessarily inhibit the institution of derivative actions. But apparently it is the contention of the petitioners that the Legislature had no power to impose any conditions so far as the *institution* of a derivative action is concerned, but was required to adopt some kind of remedy which would apply to the handling of the litigation *after* it was instituted.

Thus they suggest that the Legislature should have adopted a statute abolishing so-called "secret settlements". No doubt legislation against "secret settlements" would serve a good purpose, but that would fall far short of remedying the type of evil with which the New Jersey Legislature was concerned. The parties defendant would have the same desire to avoid the great expense and harassment incident to litigation; and the instigators of strike-litigation would know full well that such desire would exist. After an offer of settlement to avoid these results, a court has no basis on which to disapprove the settlement of an unmeritorious action, for it does not have the time or the facilities to make an investigation of the facts that lie behind the agreed settlement. And, contrary to the expectations of the plaintiff-stockholder, a settlement may not be forthcoming. In that event the plaintiff will either have to go through with his groundless litigation or to abandon it at some stage. In either case the corporation would be left to bear the expense and damage which had been caused.

There is no adequate basis for stopping the evils incident to derivative actions except by the adoption of adequate conditions to the institution and prosecution of such actions. In any event, it cannot be justifiably asserted that the Legislature of New Jersey could not reasonably so believe.

(c)

The statute merely made the prosecution of derivative actions subject to reasonable conditions.

While, as we have shown above (pp. 44-49), New Jersey could have unconditionally prohibited derivative actions in view of the evils found to exist, the New Jersey statute merely imposes conditions which, in the light of the circumstances referred to above, pp. 50-59, are certainly not arbitrary or unreasonable.

The power of the Legislature to subject the prosecution of actions to conditions precedent cannot be questioned. In *Jones v. Union Guano Co.*, 264 U. S. 171, 181 (1924), this Court held that

> "The Fourteenth Amendment does not prevent a State from prescribing a reasonable and appropriate condition precedent to the bringing of a suit of a specified kind or class so long as the basis of distinction is real, and the condition imposed has reasonable relation to a legitimate object."

For very good reasons, the petitioners do not refer to any authorities which have even a remote bearing on the reasonableness of the first two alternatives under which a stockholder may qualify to prosecute a derivative action, namely, enlisting the support of the required percentages of stock ownership. And if these alternatives represent reasonable conditions, the presence of a third alternative, even if unreasonable, could not possibly invalidate the statute.

Moreover, petitioners do not refer to any cases which support their assertion that the requirement of security is an unreasonable condition. They refer exclusively to cases dealing with conditions applicable to the enforcement by a party of a cause of action which is his own property. But what may be unreasonable in such a case can be entirely reasonable where the plaintiff undertakes to enforce the property rights of others and subjects them to a risk of loss.

Further, this Court has consistently held that it is reasonable and constitutional to condition the prosecution of a cause of action on the assumption of liability for the adversary's reasonable counsel fees.

Life & Casualty Co. v. *McCray*, 291 U. S. 566 (1934);

Dohany v. *Rogers*, 281 U. S. 362 (1930);

Sioux County v. *Nat. Surety Co.*, 276 U. S. 238 (1928);

Missouri, Kansas & Texas Ry. v. *Cade*, 233 U. S. 642 (1914).

In *Life & Casualty Co.* v. *McCray*, *supra*, Mr. Justice Cardozo, speaking for the Court, said (at p. 569):

> "There are systems of procedure neither arbitrary nor unenlightened, and of a stock akin to ours, in which submission to such a burden [the adversary's counsel fees] is the normal lot of the defeated litigant. * * *. The assurance of due process has not stereotyped bills of costs at the rates known to the Fathers."

In *Dohany* v. *Rogers*, *supra*, the Court said (at p. 368):

> "A state may allow the recovery of an attorney's fee in special classes of proceedings while withholding them in others."

With respect to conditioning the prosecution of an action on the posting of security, it has even been held by this Court that the enjoyment and use of one's own property may be conditioned on putting up security.

Thus, in *Gant* v. *Oklahoma City*, 289 U. S. 98 (1933), a city ordinance was involved which provided that no oil well should be drilled within the city limits until there should be filed with the city clerk a bond in the sum of $200,000 covering each well. The plaintiffs alleged that they had contracted for drilling on their land and that the work had begun and was in progress, but that the city threatened to forcibly stop the work unless they executed a bond in the sum of $200,000, and contended that the ordinance was unreasonable and unconstitutional, and if enforced would have the effect of depriving them of valuable property rights without due process of law. However, Mr. Justice Sutherland, speaking for a unanimous court, had little difficulty in rejecting these contentions. He said (at p. 101):

> "In view of the peculiar dangers incident to the drilling and operation of an oil or gas well within the limits of a city and of the large interest involved if the well be successful, neither the requirement for a bond nor the amount fixed can be declared arbitrary or unreasonable."

Referring to appellees' allegation that they were unable to furnish the bond, Mr. Justice Sutherland said (at p. 102):

> "Whether the judgment of the common council of the city in the present case was wise, or whether the requirement will produce hardship in particular instances, are matters with which this court has nothing to do. It is impossible for us to say that the provisions of the ordinance are clearly arbitrary and unreasonable. If there be room for fair debate,

this court 'will not substitute its judgment for that of the legislative body charged with the primary duty and responsibility of determining the question.' * * * The fact that appellants, for reasons peculiar to themselves, could not meet the imposed requirements does not militate against the constitutionality of the ordinance. * * * An otherwise valid statute or ordinance * * * is not rendered invalid merely because it chances that particular persons find it hard or even impossible to comply with precedent conditions * * *."

It is submitted that this case is decisive of the due process point here involved. This Court there upheld the requirement of posting security as a condition precedent to the use by a person of his own property, where such use involved a risk of loss and damage to others. *A fortiori* it must be permissible to subject the bringing of a derivative stockholders' action to such a condition precedent, where the stockholder does not assert his own property rights, but merely acts as an instigator for the protection of the corporation's property rights, and where loss and damage will be inflicted on the corporation if the action is unsuccessful.

B.

The Statute Does Not Violate the Equal Protection Clause.

In attacking the classification adopted by the New Jersey Legislature as violating the equal protection clause, the petitioners resort to the same method employed in connection with their attack under the due process clause. They again attack the motive of the Legislature and attempt to shift the burden to the Legislature to show that there was no basis on which any person could reasonably disagree with the classification adopted by it.

However, the classification used by the New Jersey gislature must be upheld unless it is clearly shown that can be supported on no rational basis. In view of the t that this is a statement of an old established principle constitutional law, no extended discussion is called for d we will merely refer to two decisions by this Court in ich the legal point involved has been unequivocally ablished.

In *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U. S. 61, (1911), the Court said:

> "The equal protection clause of the Fourteenth Amendment does not take from the State the power to classify in the adoption of police laws, but admits of the exercise of a wide scope of discretion in that regard, and avoids what is done only when it is without any reasonable basis and therefore is purely arbitrary. * * * When the classification * * * is called in question, if any state of facts reasonably can be conceived that would sustain it, the existence of that state of facts at the time the law was enacted must be assumed."

In *Clark* v. *Paul Gray, Inc.*, 306 U. S. 583, 594 (1939), Court's function in determining the validity of a statute der the equal protection clause is stated by Mr. Justice one as follows:

> "The classification * * * is a legislative, not a judicial, function. Its merits are not to be weighed in the judicial balance and the classification rejected merely because the weight of the evidence in court appears to favor a different standard. * * * The determination of the legislature is presumed to be supported by facts known to it, unless facts judicially known or proved preclude that possibility. * * * Hence, in passing on the validity of the present

> classification, it is not the province of a court to hear and examine evidence for the purpose of deciding again a question which the legislature has already decided. Its function is only to determine whether it is possible to say that the legislative decision is without rational basis."

Thus, it is wholly irrelevant to the constitutional law question raised to consider whether the Legislature acted wisely or whether the classification adopted has some defects or whether some other classification might have been adopted which would have been better. The only question is whether there was some rational basis for the classification which the Legislature did adopt.

A mere statement of the real issue involved discloses the contention of the petitioners to be without substance.

As shown above, the Legislature found that the prosecution of stockholders' derivative actions had "been subject to great abuse and malodorous scandal." This abuse had resulted from the prosecution of derivative actions by stockholders holding only a few shares of stock and having no real economic interest in, and no concern as to, the effect of the litigation on the welfare of the corporation.

An analysis of 1400 stockholders' derivative actions which were instituted during the ten-year period 1932-1942 shows that in the case of actions brought by holders of less than 5% of the stock only 2% of the actions were held to be meritorious. (Wood, *Survey and Report Regarding Stockholders' Derivative Suits* (1944) pp. 16, 30, *et seq.*) It is said that these figures do not show that a greater percentage of meritorious actions were instituted by those holding more than 5%. But against this pure speculation, it is admitted that practically all of derivative actions were instituted by persons holding only a few shares of stock.

The experience of the courts with abusive derivative suits instituted by stockholders owning merely a few shares of stock is illustrated by the following cases:

In dismissing a stockholders' suit, the court pointed out in *Hauben* v. *Morris*, 255 App. Div. 35, 37, 5 N. Y. S. 2d 721, 723 (1st Dept. 1938), aff'd 281 N. Y. 652, 22 N. E. 2d 482 (1939):

> "The suit was commenced in the latter part of 1934, a few days after the plaintiff Hauben had become a stockholder of record of sixteen shares of one dollar par value stock (at a cost to him of twenty-seven dollars) out of a total of $4,591,000 par value of stock outstanding".

In *Weinberger* v. *Quinn*, 264 App. Div. 405, 409, 35 N. Y. S. 2d 567, 572 (1st Dept. 1942), aff'd 290 N. Y. 635, 49 N. E. 2d 131 (1943), the court again stressed the important bearing of this factor when it said:

> "A stockholder's derivative suit may be a useful agency or it may be grossly abused for purposes far removed from any desire to do a service to the corporation represented. The prevalence of suits of the latter nature appears to have recently caused the Legislature to enact a statute requiring the corporation to pay the expenses of directors who are successful on the trial of this form of action. * * *
>
> "When we find a stockholder, owning fifty shares out of upwards of 7,000,000 shares, seeking to enforce alleged rights of his company, with the possibility of subjecting it to these large statutory costs and expense in the event of failure, we think it is the duty of the courts to require at least the statement of more than a mere general charge of wrongdoing before resort to equity may be had."

Again, in *Hayman* v. *Morris*, 36 N. Y. S. 2d 754, 764 (Sup. Ct., N. Y. Co., 1941), the court, in dismissing the complaint on the merits, said:

> "The defendants further claim that plaintiffs have not brought this action in good faith but that it was begun for other reasons and for personal gain to themselves and for others allied with them.
>
> "I might say at this stage that I am rather inclined to so view the bringing of this action when the actual benefits in dollars and cents which may accrue to plaintiffs and which they may derive from success of this litigation are considered, and it is somewhat difficult to believe that they have really brought this action also for the benefit of all the other stockholders who, to date, it appears, have evinced no desire to intervene or otherwise participate and whose holdings far exceed the meager holdings of the plaintiffs."

In *Clark* v. *National Linseed Oil Co.*, 105 Fed. 787 (7th Cir. 1901), the court found evidence of bad faith in the fact that the plaintiff stockholders owned 3% of the stock, saying (at p. 794):

> "These strictures upon the bill, as an affidavit, would be cogent, had all the stockholders, or a large proportion of them joined the appellants in their attack upon the president and directors; but they are still more cogent, when it is borne in mind that ninety-seven per cent. of the stockholders refuse such an affiance. Is it not probable that the ninety-seven knew, as well as the three, the details of these transactions? Is it probable that they would acquiesce in the misconduct alleged—misconduct so harmful to their interests? Under circumstances like these, there should be the clearest and most convincing presentation, in the affidavit, of the facts—each material one within the personal knowledge of the wit-

> ness—to justify the court in disregarding the judgment of the ninety-seven, in an effort to meet the wishes of the three."

In *Bookman* v. *R. J. Reynolds Tobacco Co.*, 138 N. J. Eq. 312, 409, 48 A. 2d 646, 700 (1946), the Court of Chancery quotes with approval from the unreported case of *Wallen* v. *Duro-Test* as follows:

> "Complainant seeks by this suit to establish rights of Duro-Test against the defendants, rather than his individual rights and in such a suit the motives of the complainant are a proper subject of inquiry. * * * Considering this complainant's infinitesimal proportionate interest in Duro-Test stock issue, it does not seem that he is moved solely by a desire to benefit other stockholders who decline to join in his attacks on the defendant's acts, but that an ulterior motive has prompted this suit."

Unless the New Jersey Legislature had desired to completely outlaw derivative actions or unless it desired to require security in all derivative actions, it had of necessity to make *some* classification. Indeed, if the New Jersey Legislature had made no classification at all, petitioners would have been the first to attack the statute, for they claim that the requirement of security is a practical equivalent of outlawing the action and that that is unconstitutional.

And yet the petitioners do not tell us what kind of classification they would have had the Legislature make. Apparently they take the position that the statute would have been unconstitutional if no classification had been made, and it would be equally unconstitutional if any classification had been made.

We will now show that the particular classification adopted by the New Jersey Legislature not only had a

rational relation to the evil involved, and thus fully met the constitutional requirements, but also that it was a wholly reasonable and fair classification in the light of the evil involved.

The evil which existed involved the instigation by lawyers of derivative actions in the name of a stockholder holding an insignificant fraction of the total stock of the corporation. The first requirement of a reasonable classification was that it must be aimed at this evil; and the classification adopted by the New Jersey Legislature was directly aimed at this evil.

Experience had shown that, while lawyers could find one or two stockholders in a corporation who were willing to have their names used in connection with questionable litigation, they would probably not find very many stockholders who would permit their names to be so used; and that while lawyers could find one stockholder having an insignificant fraction of the total stock of a corporation who would permit his name to be used in questionable litigation, they would probably not find one stockholder having a substantial interest in the corporation who would permit his name to be so used. And so the New Jersey statute made an appropriate classification to cover this entire situation.

In the first place, it provided that if a *number* of stockholders joined together who owned a maximum of 5% in the case of small corporations and a proportionately smaller percentage in the case of large corporations (for example only 1/10 of 1% in the case of a corporation whose outstanding stock has a market value of $50,000,000), an action could be prosecuted without any restriction or without putting up any security.

In the second place, it provided that if any *one* stockholder fulfilled the same requirements as to percentage of

total stock, he could prosecute a derivative action without any restrictions or without putting up any security.

It is difficult to see how the classification could have been more reasonable or fair. Surely no one would suggest that if 4 stockholders owning 1% of the stock could prosecute a derivative action without any restrictions or without putting up security, *one* stockholder owning the same percentage of stock should not have the same privilege, or vice versa. Surely no one would suggest that the statute was unreasonable because it did not require a *larger* percentage of stock ownership than it did. And surely no one would suggest that if it were appropriate for the Legislature to fix *any* minimum percentage of ownership, it was unreasonable to fix a percentage of 5% in the case of small corporations which generally are closely held or of progressively smaller percentages in the case of the large public corporations which, as above stated, amounts to only 1/10 of 1% in the case of a $50,000,000 corporation.

What arguments then are made in support of the petitioners' position?

First, it is argued that this classification discriminates against the poor in favor of the wealthy, and the Legislature is accused of being so motivated. The purpose of this argument is transparent and it has no validity whatever. The fact that one person owns one share of stock in a *particular* corporation and another owns 50 shares in that same corporation is no index of the comparative wealth of the two persons.

More than that, the purpose of this legislation is to protect the welfare of the corporation as a whole and that means protecting all of the stockholders, both poor and rich alike; and since, as the petitioners themselves assert, the vast majority of corporate stock is held by small

owners, it is inappropriate for the petitioners to accuse the Legislatures of New Jersey, New York, Pennsylvania, Maryland and Wisconsin of having the motive of protecting wealthy stockholders.

The petitioners might just as well argue that corporations should no longer be controlled by a majority of its stockholders, for certainly under that rule of law the large stockholders have more power than the small stockholders.

In the second place, it has been asserted that the classification is arbitrary because "whether a baseless derivative action be brought by a $10,000 stockholder in a $1,000,000 corporation, or by a $50,000 stockholder in a $5,000,000 corporation, the value of plaintiffs' stock would in each case be reduced by precisely the same amount * * *"; that the "motives of self-interest, counseling against the institution of the action, would thus in both cases have precisely the same weight."; and that "the plaintiff in the first case would, under the statute, have to give security, while the plaintiff in the second case would be exempt."

The one circumstance alleged in the one particular instance referred to results, of course, from permitting a derivative action to be prosecuted without restriction by the holders of stock having a value of $50,000 *or* representing 5% of the stock, whichever is easier to comply with. As in every conceivable classification, a borderline example may be found where no substantial difference will exist in some particular respect. But the question is whether the overall objectives have a reasonable relation to the evil found to exist. As shown above, in providing for these alternative ways of qualifying, the statute made an allowance for the practical situation that a stockholder in the larger corporation, with its stock more widely distributed in small holdings, will probably have more difficulty in enlisting the support of the same percentage of stock-

holders than a stockholder in the smaller, more closely held, corporation. Moreover, as will be shown immediately below, even a single stockholder with a $50,000 investment has a greater interest in the financial well-being of a corporation than a single stockholder with a $10,000 investment.

In the third place, it has been argued, in a vein similar to the argument referred to above, that if an action were brought by a $50,000 stockholder, the decrease in the book value of his stock threatened by the corporation's prospective litigation expenses would amount to a "paltry sum" which could not possibly operate as a deterrent discouraging a large stockholder from instituting a baseless derivative action.

This argument again seizes upon one factor (which is obviously insignificant) and overlooks all the other factors which are very significant. The economic interest which restrains a "large" stockholder from involving his corporation in groundless litigation is something more than his proportionate share of the expenses of litigation. He has a real stake in the financial well being of the company. The necessity to pay $100,000 of litigation expenses may in a given case weaken the cash position of a corporation and injure its business activities. He is interested in the zeal and competency of its management. The necessity of the executives of the company to be subjected to long examinations before trial interferes with their attention to business affairs. Charges made against corporation executives of fraud and misappropriation of assets (which appear in practically every derivative suit) may injure the corporation's reputation and business.

Further, persons who desire to participate in strike litigation would not be averse to "investing" $100 in several corporations but the necessity to invest $50,000 in several

corporations for such a purpose would certainly be a restraining influence. It has been recognized both by legislatures and by court rules that buying into strike litigation has been a real evil; and derivative actions have been forbidden by a stockholder who had purchased his stock after the alleged cause of action accrued. However salutary that restriction may be, it has not eliminated the opportunity for the kind of abuse referred to above. If a person intends to participate in the prosecution of *strike* litigation, his groundless allegations can be directed to any period of time.

Finally, this argument assumes that qualifying through the ownership of $50,000 of stock is a privilege which the statute confers on a *single* stockholder owning that amount of stock. It entirely overlooks that this provision of the statute permits any number of small stockholders to combine together to meet this qualification. As we have pointed out above, this provision of the statute enables small stockholders to prosecute a derivative action on the basis of progressively smaller percentages of the total stock of a corporation as the corporation gets larger. It is difficult to see why the petitioners protest as unreasonable a provision in the statute which would reduce the requirement that a small stockholder enlist the support of 5% of the stockholders to as low as, for example, 1/10 of 1% in the case of the $50,000,000 corporation.

All of the arguments which petitioners make against the classification which was adopted by the New Jersey Legislature are matters for legislative and not judicial consideration. All of the factors that they refer to and all of the factors we refer to, and still other factors, are matters to be weighed in the balance by the Legislature. They go to the wisdom of the classification. Maybe it can

be improved. But so far as we can see the Legislature did a good job with a difficult problem. And in any event it cannot justifiably be claimed that the classification which it adopted had no reasonable relation to the elimination of the evil with which it was concerned.

Finally, it should be pointed out that the very kind of classification here involved has been widely adopted in fixing the rights of stockholders.

The Trust Indenture Act of 1939 makes provision in section 315(e) (15 U. S. C. § 77ooo(e)), for the inclusion in a qualified trust indenture of a requirement for an undertaking for costs, including reasonable attorneys' fees. However, the section expressly provides that its provisions shall not apply "to any suit instituted * * * by any indenture security holder, or group of indenture security holders, holding in the aggregate more than 10 per centum in principal amount of the indenture securities outstanding, * * *"

Numerous state statutes require minimum percentage qualifications of stockholders before rights accrue or action can be taken, such as

(1) California—Corporations Code, Section 811 requires that a suit for the removal of a director for dishonesty or gross abuse of authority be brought by at least 10% of the stockholders.

(2) California — Corporations Code, Section 4600 requires action for voluntary dissolution to be brought by holders of not less than 50% of the outstanding stock.

(3) California—Corporations Code, Section 3095 provides that the Superior Court may enforce the right of inspection of corporate books and records on the application of 10% of the stockholders and also requires that the expense of such inspection or in-

vestigation be paid by the applicant unless the court orders them to be paid or shared by the corporation. Section 3011 provides that the shareholders holding at least 10% of the stock may make written request to the Secretary or Treasurer for a statement of its affairs where no statement is given to shareholders for the preceding six months.

(4) Connecticut—Gen. Stat. (1949) § 5226 requires 10% of the stockholders for petition for involuntary dissolution even though action is based on fraud, collusion or gross mismanagement.

(5) New Jersey—R. S. 14:14-3 gives stockholders owning 10% of stock the right to petition for a receiver of an allegedly insolvent corporation.

(6) New York—Stock Corporation Law, §§ 10 and 113 limit the right of inspection of stock books to stockholders of record for at least six months or those holding or authorized by 5% of the outstanding shares (§ 115 provides similarly as to voting trust certificates).

(7) New York—Stock Corporation Law, § 77 gives stockholders owning 3% of the shares of a corporation the right to request a statement of its affairs.

(8) Pennsylvania—Statutes Annotated (Purdon), Title 15 § 2852-405 (C) authorizes the removal of directors for fraud or abuse of authority upon the petition of holders of 10% or more of the stock.

(9) Virginia Code (1936) § 3810(b) limits suit for dissolution of a corporation to holders of at least 25% of stock.

C.

The Application of the Statute to Actions Pending at the Time of its Enactment Does Not Violate the Due Process or Contract Clause.

The petitioners contend that even if the statute is not otherwise unconstitutional, in any event its application to actions pending at the time of its enactment violates the due process and contract clauses of the Constitution. There is also no merit to this contention.

It should be noted at the outset that it is only in a very limited sense that this statute has any retroactive application. It is not retroactive in the sense that it imposes a liability on a person for acts performed in the past or that it restricts or impairs any property rights by reason of acts performed in the past. It merely imposes conditions on instituting or proceeding with the prosecution of an action in the courts of New Jersey and, as shown above, these conditions are not arbitrary or unreasonable in the light of a public evil found to exist.

Thus, the substantial effect of the statute is prospective rather than retroactive in its application. The evil found to exist relates not to the mere act of *instituting* a derivative action but to the continuing process involved in its *prosecution*. The loss and damage which the statute is designed to prevent will be caused by acts performed after the enactment of the statute, that is, the continued prosecution of the action.

In any event, it is settled beyond doubt that the mere fact that a statute is retroactive does not make it unconstitutional. This Court so held in *Blount* v. *Windley*, 95 U. S. 173, 180 (1877). The rule is stated as follows in the recent

case of *Fisch* v. *General Motors Corp.*, 169 F. 2d 266, 271 (6th Cir. 1948), cert. denied 335 U. S. 902 (1949):

> "... retroactive laws are not prohibited by the Constitution in civil cases. We have no power to declare them void upon that ground alone. Blount *v.* Windley, 95 U. S. 173, 180; Watson *v.* Mercer, 33 U. S. 56, 70."

Thus, the "retroactive" effect does not render an otherwise constitutional statute unconstitutional. The petitioners must show an unreasonable deprivation of their property in order to render the application of the statute to them unconstitutional. We have already shown *supra* under Point A, 2, that there is no basis for such a showing, and petitioners' arguments under this point are likewise insufficient to meet that test.

Petitioners state on page 33 of their brief that "as a result of the serious constitutional questions which would otherwise have arisen, the New York courts construed Section 61-b as being prospective in operation only." This is not a correct statement of the law of New York. In the first place, while the Court of Appeals has held that as a matter of statutory construction the statute was not intended to apply to actions pending at the time of its enactment, this was neither in whole nor in part based on constitutional grounds. Indeed, the Appellate Division, First Department, has expressly held that the statute could constitutionally be applied to pending actions.

> *Shickrawi* v. *Moffett*, 268 App. Div. 352, 51 N. Y. S. 2d 188 (1st Dep't 1944), aff'g 49 N. Y. S. 2d 64 (Sup. Ct., N. Y. Co., 1944), rev'd on other grounds 294 N. Y. 180, 61 N. E. 2d 435 (1945);

Coane v. *American Distilling Co.*, 270 App. Div. 1001, 63 N. Y. S. 2d 829 (1st Dept. 1946), aff'g 182 Misc. 926, 49 N. Y. S. 2d 838 (Sup. Ct. N. Y. Co., 1944), rev'd on other grounds 298 N. Y. 197, 81 N. E. 2d 87 (1948);

Burnham v. *Brush*, 78 N. Y. S. 2d 562 (App. Div., 1st Dep't 1948).

These holdings still stand, since the Court of Appeals did not have occasion to pass on the question.

In the second place, the constitutionality of the retroactive application of the statute to stockholders who had acquired their shares prior to its enactment and to causes of action which had accrued prior thereto has been upheld by the New York Court of Appeals in *Myer* v. *Myer*, 296 N. Y. 979, 73 N. E. 2d 562 (1947), aff'g 271 App. Div. 465, 66 N. Y. S. 2d 83 (1st Dep't 1946). The record in *Lapchak* v. *Baker, supra,* also shows that there the New York Court of Appeals upheld the constitutionality of the statute as applied to a plaintiff who became a stockholder in 1938 and to a cause of action which accrued in 1942, both several years prior to its enactment.

If it is constitutional to apply the statute retroactively to stockholders who acquired their shares prior to its enactment and to causes of action accrued prior thereto, it is immaterial whether or not suit was pending at that time. Rights otherwise subject to modification do not acquire a constitutional immunity merely because suits for their enforcement are begun. There is nothing sacrosanct about the institution of an action. There is no distinction between the rights of a stockholder in a pending action and those prior to its institution. In both cases, the alleged property right of a stockholder is exactly the same, namely, his alleged right to prosecute a derivative action. The

nature of this right is exactly the same before and after a complaint is filed. Thus, the question of the statute's application to pending action is merely one of legislative intent, and the Legislature of New Jersey has clearly expressed its intent on the point.

It follows that petitioners' position must rest on the proposition that the statute may not constitutionally be applied to stockholders who became such, and to causes of action which accrued, prior to its enactment. It is submitted that merely to state the proposition is to refute it. If the statute could not be applied to anyone who became a stockholder prior to 1945, it could be rendered ineffective for many years to come. The Legislature having found that an evil existed now, it surely had the power to provide a remedy effective now, rather than in the distant future. It was no more than reasonable for the Legislature to make the statute retroactive in that sense.

Petitioners assert that the statute here involved takes away every remedy for past wrongs. It is clear, however, that there is still an effective procedure to redress any past wrongs that the individual defendants may have committed against the corporation. Chapter 131 does not abolish any cause of action. The claims asserted against the individual defendants are not outlawed and can be asserted by any stockholder meeting the statutory requirements. The statute thus merely relates to the form of remedy and, as such, applies to pending actions.

Despite petitioners' assertion (on p. 34 of their brief) that the application of the statute not only to pre-existing causes of action but to pre-existing suits thereon makes this case unique, the fact is that in numerous cases statutes divesting causes of action involving even a plaintiff's *personal* rights have been held constitutional, as applied to

pending actions. In addition to the cases cited by the court below, reference is made to the recent cases upholding the application of the so-called Portal-to-Portal Act to suits pending at the time of its enactment.

Battaglia v. *General Motors Corp.*, 169 F. 2d 254 (2d Cir. 1948), cert. denied 335 U. S. 887 (1948);

Darr v. *Mutual Life Insurance Co.*, 169 F. 2d 262 (2d Cir. 1948), cert. denied 335 U. S. 871 (1948);

Seese v. *Bethlehem Steel Co.*, 168 F. 2d 58 (4th Cir. 1948);

Atallah v. *B. H. Hubbert & Son*, 168 F. 2d 993 (4th Cir. 1948), cert. denied 335 U. S. 868 (1948);

Fisch v. *General Motors Corp.*, 169 F. 2d 266 (6th Cir. 1948), cert. denied 335 U. S. 902 (1949);

Rogers Cartage Co. v. *Reynolds*, 166 F. 2d 317 (6th Cir. 1948).

In those cases, pending actions were dismissed in which the plaintiffs asserted their own rights to compensation valid and enforceable at the time the actions were commenced. *A fortiori*, it cannot violate the Constitution to apply Chapter 131 to a pending action where the cause of action does not belong to the plaintiff.

Petitioners further assert the application of Chapter 131 to a pending suit violates the contract clause of the Constitution. However, the conclusive answer to this contention is that the right to bring a derivative action is not a contract right. The right to bring a derivative action is merely a remedy created by the general common law applied

in equity courts. It is no more of a contract right than the right to get injunctive relief in certain situations or the right to have various common law writs issued or any of the other remedial process which have been adopted and changed from time to time.

Thus, it has been expressly held that the right to bring a derivative action does not fall within the protection of the contracts clause of the Constitution. In *Myer* v. *Myer*, 271 App. Div. 465, 474, 66 N. Y. S. 2d 83, 92 (1st Dept. 1946), aff'd 296 N. Y. 979, 73 N. E. 2d 562 (1947), the court, in upholding the constitutionality of the similar New York legislation, said:

> "The right [to bring a derivative action] is not so intimate in its relation to any contract rights of the stockholders as to be within the obligation of contract and thus immune from change."

However, even making the far-fetched assumption that a contractual right was involved, it is a principle of constitutional law that every contract is subject to the paramount police power of the State, and can be modified, burdened, and even abrogated, in the reasonable exercise of that power.

In *Home Building & Loan Association* v. *Blaisdell*, 290 U. S. 398, 434 (1934), Mr. Chief Justice Hughes, speaking for the Court, said:

> "Not only is the constitutional provision [of the contract clause] qualified by the measure of control which the State retains over remedial processes, but the State also continues to possess authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end 'has the result of modifying or abrogating contracts already in effect.' *Stephenson* v. *Binford*, 287 U. S. 251, 276."

That Chapter 131 does not violate the contracts clause, follows *a fortiori* from the case of *Veix* v. *Sixth Ward Association*, 310 U. S. 32 (1940). In that case, the stockholder had purchased shares in a New Jersey building and loan association in 1928 and 1929. At that time the applicable New Jersey statutes provided *inter alia* that shares in such an association could be withdrawn by giving such written notice as the constitution or by-laws of the association provided, not to exceed 30 days, and that thereupon any member could recover the withdrawal value of his shares. A statute passed in 1932 provided among other things that so long as the funds of an association were applied as required by the 1932 statute, no member should have a right to recover the withdrawal value of his shares.

The plaintiff shareholder attacked the 1932 statute as violative of the contract clause. The New Jersey Court of Errors and Appeals upheld the constitutionality of the statute and this Court affirmed. This Court pointed out that the statute was passed in the public interest to protect the welfare of the associations and was a valid exercise of the police power. In holding that the statute did not violate the contract clause, the Court said (at p. 38):

> "This is so because the obligation of the Association to respond to the application for withdrawal was subject to the paramount police power."

In *Battaglia* v. *General Motors Corp., supra*, the application of the Portal-to-Portal Act to pending suits was upheld on similar grounds. The court said (169 F. (2d) at p. 260):

> "If the contractual arrangements of these private parties were subject to the Fair Labor Standards Act as it might be interpreted by the courts, or were modified to take into consideration decisions con-

> struing that statute, they were also subject to changes made in it by Congress in the exercise of its power to regulate commerce."

These cases clearly establish that in the exercise of the police power, personal contract rights may be validly modified and even abrogated. *A fortiori,* the instant statute cannot violate the contracts clause, since it merely modifies a remedy given for the protection, not of the stockholder's personal rights, but of the rights of the corporation.

Moreover, it has been repeatedly adjudicated by the New Jersey courts that the application to pre-existing contracts and actions of the very kind of statute here involved, that is, a statute creating a right to counsel fees, does not violate the contracts clause.

The leading case is *Igoe Bros.* v. *National Surety Co.,* 112 N. J. L. 243, 169 Atl. 841 (1934). There, the surety company had entered into a contract of suretyship with a contractor in 1930. On April 12, 1932, plaintiff instituted suit on the bond against the surety for a balance due from the contractor. On May 2, 1932, a statute became effective, which changed the previously applicable law by providing, *inter alia,* that

> "* * * upon the trial of any such action the court shall award to the prevailing party a reasonable attorney's fee to be taxed as costs, and to be included in the judgment therein rendered."

The surety resisted liability for the attorney's fee on the ground that to apply the statute would impair the obligation of its contract. However, the Court of Errors and Appeals held that the application of the statute did not violate the contract clause.

The same holding was made in *Savitt* v. *L. & F. Construction Co.*, 124 N. J. L. 173, 10 A. 2d 728 (1940); *Robinson* v. *Jackson*, 14 N. J. Misc. 866, 187 Atl. 918 (Ct. Com. Pleas, 1936); *Murphy* v. *Brown & Co.*, 91 N. J. L. 412, 103 Atl. 28 (Sup. Ct., 1918).

D.

Application of the Statute Does Not Violate the Full Faith and Credit Clause.

Petitioners contend that because the respondent is a Delaware corporation and the Delaware law does not require the posting of security, the application of the New Jersey statute violates the full faith and credit clause. It is clear, however, that the rule adopted by the New Jersey Legislature which makes the statute expressly applicable to suits instituted in the right of foreign as well as domestic corporations, does not violate the full faith and credit clause for the following reasons:

(1) The statute merely embodies a well established principle of conflict of laws.

(2) Even if the statute changed the common law of conflict of laws, New Jersey, by reason of its paramount governmental interest, had the power to do so.

(3) In any event, the full faith and credit clause has no application to the common law of a sister state.

1. The statute merely embodies a well established principle of conflict of laws.

Under established principles of conflict of laws, a statute which merely regulates, as does Chapter 131, the conditions on which an action may be prosecuted in the State's own courts, applies to all of such actions, whether foreign or

domestic. Without such a principle, there would be no uniformity with respect to the rules governing the prosecution of identical actions in the same court. The citizens of New Jersey would be subjected to gross discrimination. One citizen, owning stock in a domestic corporation, would be required to meet the conditions of the statute, and another citizen, owning stock in a foreign corporation would be exempt.

Thus it has long been the established rule that a State may apply its own statute of limitations to bar foreign causes of action asserted within its courts. The effect of such a statute is more restrictive than the conditions imposed by Chapter 131. The former statute completely bars the prosecution of an action. Chapter 131 merely requires that a plaintiff-stockholder either enlist the support of a very small percentage of the other stockholders, or else put up security, in an amount determined by the court to be reasonable.

This rule has been applied to the very statute here involved in *Shielcrawt* v. *Moffett*, 184 Misc. 1074, 56 N. Y. S. 2d 134 (Sup. Ct., N. Y. Co., 1945). This case squarely held that Chapter 131 was "procedural" for conflict of laws purposes, the same as statutes of limitations. The court said (184 Misc. at p. 1077, 56 N. Y. S. 2d at p. 136):

> "* * * it seems to me that a major concern is whether Section 61-b is procedural in the sense that it is the type of statute which our Courts may apply conveniently, practically and properly to foreign corporations doing business in this state to the end that our procedure shall maintain a desirable measure of uniformity in derivative stockholders' suits. I believe that Section 61-b, and it must therefore follow, its New Jersey counterpart, are procedural in that sense."

2. Even if the statute changed the common law of conflict of laws, New Jersey, by reason of its paramount governmental interest, had the power to do so.

The statute did not legislate with respect to the internal affairs of a foreign corporation or with respect to the rights or liabilities between stockholders, directors and officers and a foreign corporation in connection with its internal affairs. The statute merely imposes certain legal consequences *for acts in the courts of New Jersey,* in connection with the prosecution of a derivative action. The statute was designed to cope with abusive strike suits and to protect innocent parties to such actions from sustaining heavy losses resulting from acts performed within the State of New Jersey. The statute did not change rights or liabilities respecting the relationships outside the New Jersey courts.

New Jersey has the paramount interest of making its policy uniformly applicable to the same acts performed within its boundaries, whether on behalf of a foreign or domestic corporation; and of protecting persons brought into its courts against unreasonable loss resulting from irresponsible litigation.

Thus, New Jersey has a sufficient governmental interest to enforce the statute against all litigants in its courts under the very rule which the petitioners refer to in their brief (p. 31), laid down by this Court in *Alaska Packers Ass'n* v. *Industrial Accident Commission,* 294 U. S. 532 (1935), to the effect that conflicting state policies must be reconciled

> "* * * not by giving automatic effect to the full faith and credit clause, compelling the courts of each state to subordinate its own statutes to those of the other, but by appraising the governmental interests of each jurisdiction, and turning the scale of decision according to their weight."

Manifestly, Delaware has no governmental interest at all with respect to the conditions under which actions may be prosecuted in New Jersey courts.

The courts of New York have consistently applied the similar New York statute to derivative suits brought on behalf of foreign corporations.

Moreover, it is well established that a state has a governmental interest with respect to acts performed by, or on behalf of, a foreign corporation within its boundaries, and especially in creating uniformity with domestic corporations. That is precisely what the statute here involved does. New Jersey's power to do so cannot be questioned. Thus, it was stated in *New York Life Insurance Co.* v. *Cravens*, 178 U. S. 389, 401 (1900):

> "The power of a State over foreign corporations is not less than the power of a State over domestic corporations. No case declares otherwise. We said in *Orient Ins. Co.* v. *Daggs, supra*: 'That which a State may do with corporations of its own creation it may do with foreign corporations admitted into the State. * * * The power of a State to impose conditions upon foreign corporations is certainly as extensive as the power over domestic corporations * * *.'"

Accord:

> *Osborn* v. *Ozlin*, 310 U. S. 53 (1940);
> *Hoopeston Co.* v. *Cullen*, 318 U. S. 313 (1943).

In the *Hoopeston Co.* case, this Court said (at p. 320):

> "Nothing in the Constitution requires a state to nullify its own protective standards because an enterprise regulated has its headquarters elsewhere. * * * Where as here the state has full power to prescribe the forms of contract, the terms of protec-

> tion of the insured, and the type of reserve funds needed, 'the mere fact that state action may have repercussions beyond state lines is of no judicial significance.' *Osborn* v. *Ozlin, supra,* at 62."

The case of *Broderick* v. *Rosner,* 294 U. S. 629 (1935), relied on by the petitioners, is inapplicable to the instant case. In that case, New Jersey attempted to prevent foreign corporations from enforcing against its citizens an obligation to pay assessments voluntarily assumed by them under the laws of the state of incorporation, while at the same time permitting actions to recover assessments made by domestic corporations. Thus, New Jersey had no public policy against actions of that nature; and manifestly it had no legitimate *governmental* interest at all in helping individuals to escape from the payment of a just obligation.

3. Finally, in no event does the full faith and credit clause have any application to this case.

Article IV, Section 1 of the Constitution provides as follows:

> "Full faith and credit shall be given in each State to the public Acts, Records, and Judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof."

This provision does not embrace common law, as distinguished from the statutes of a sister State. None of the words, "public Acts," "Records" or "Judicial Proceedings" embrace unwritten law. Moreover, in conferring power on the Congress to prescribe the manner in which such acts, records and judicial proceedings shall be *proved,*

it was made clear that the clause was not applicable to the common law of a sister State.

As elsewhere, the remedy of derivative stockholder's suits in Delaware was not created by statute, but was developed in the courts of equity. If in Delaware a plaintiff-stockholder need not give security out of which the corporation may seek reimbursement, this is so because of the failure of the *common* law of Delaware to set up such requirement. There is no Delaware statute on the point.

This Court has never held that the full faith and credit clause may compel a state to apply the common law of another state. Petitioners' assertion to the contrary on p. 31 of their brief is incorrect. *Aetna Life Insurance Co.* v. *Dunken*, 266 U. S. 389 (1924), involved the question whether Texas had to give full faith and credit to a Tennessee *statute*, 1917 Tenn. Code §3369a 141. In *Order of United Commercial Travelers* v. *Wolfe*, 331 U. S. 586 (1947), the Court was careful to point out the public acts of Ohio to which full faith and credit had to be given (pp. 591-592).

Petitioners' attempt to transform the question into one of statutory law by referring to Delaware's reception statute enacted in 1776 (note 12, p. 30 of their brief) is unworthy of consideration. According to their own statements on p. 18 of their brief, stockholders' derivative suits were not known in 1776.

Even if there were a Delaware statute on the point, there would be no conflict with Chapter 131, and hence the full faith and credit clause would not be applicable. For a Delaware statute regulating the prosecution of derivative actions in its courts would not even purport to apply to actions in the courts of New Jersey.

As would be expected from the well established principles referred to above, the courts of New York have consistently applied the similar New York statute to derivative suits brought on behalf of foreign corporations. The argument of the petitioners here is an almost exact copy of the argument submitted to the New York Court of Appeals in *Lapchak* v. *Baker, supra,* which was also a suit brought in the right of a Delaware corporation. As already pointed out, the Court of Appeals rejected this argument and held that the statute could constitutionally be applied in such case.

CONCLUSION.

The judgment of the Court of Appeals for the Third Circuit should be affirmed in all respects.

Respectfully submitted,

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Appendix A.

Statutes and Rules Involved.

Chapter 131 of the New Jersey Laws of 1945 (R. S. Cum. Supp. 1945/1947, 14:3-15, 14:3-17), insofar as here applicable, has been set forth *supra*, on pages 2-3.

28 U. S. C. §1291 provides as follows:

> "The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the District Court for the Territory of Alaska, the United States District Court for the District of the Canal Zone, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court."

28 U. S. C. §1651(a) provides as follows:

> "The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions agreeable to the usages and principles of law."

28 U. S. C. §1652 provides as follows:

> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

Rule 23 of the Federal Rules of Civil Procedure provides as follows:

"(b) *Secondary Action by Shareholders.* In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reason for his failure to obtain such action or the reasons for not making such effort.

(c) *Dismissal or Compromise.* A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. If the right is one defined in paragraphs (2) or (3) of subdivision (a) notice shall be given only if the court requires it."

Rule 15 of the General Rules of the District Court of the United States for the District of New Jersey provides as follows:

"*Applicability of State Court Procedure.* In circumstances not provided for by the Federal Rules of Civil Procedure, or by these rules, the procedure and practice of the Courts of the State of New Jersey shall govern."

le 45 of the Civil Rules of the United States District
urt for the Eastern District of New York provides as
ows:

"*Procedure in Absence of Rule.* Whenever a procedural question arises which is not covered by the provisions of any statute of the United States, or of the Federal Rules of Civil Procedure, or of these rules, it shall be determined, if possible, by the parallels or analogies furnished by such statutes and rules. If, however, no such parallels or analogies exist, then the procedure heretofore prevailing in courts of equity of the United States, or in default thereof the procedure which shall then prevail in the Supreme Court of the State of New York shall be applied."

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OCTOBER TERM, 1948

No. 442

HANNAH COHEN, Executrix of the Estate of SOL COHEN, deceased, and DAVID E. COHEN, Intervenor,
Petitioners,

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Respondents.

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR LEAVE TO FILE BRIEF
AND
BRIEF FOR WILLIAM B. WEINBERGER AS *AMICUS CURIAE*

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Supreme Court of the United States

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No. 442

HANNAH COHEN, Executrix of the Estate of SOL COHEN, deceased, and DAVID E. COHEN, Intervenor,
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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION OF WILLIAM B. WEINBERGER FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE*

TO THE HONORABLE CHIEF JUSTICE AND THE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petitions of William B. Weinberger respectfully shows to this Court and alleges:

1. Petitioner respectfully asks the Court's permission to file the annexed brief *amicus curiae* on the constitutional

validity of § 14:3-15 of the Revised Statutes (Cum. Supp.) of the State of New Jersey. The constitutional validity of the statute is directly before this Court on the writs of certiorari granted in the two above-entitled cases.

2. R. S. 14:3-15 provides, in substance, that the plaintiff in a stockholder's derivative action, who owns less than 5% or $50,000 worth of his corporation's stock, shall be required to give security for the reasonable expenses, including attorneys' fees, which may be incurred by the corporation and the other defendants in the action. The full text of said statute appears in the brief submitted herewith.

3. Petitioner is the plaintiff in a stockholder's derivative action pending in the Supreme Court of the State of New York, County of New York, entitled "William B. Weinberger v. Milton Sperling, et al." (County Clerk's Index No. 3768/1949). By decision of said Court (New York Law Journal, March 15, 1949, p. 943, col. 1), petitioner has been required, pursuant to § 61-b of the General Corporation Law of New York, to give security in the sum of $25,000 for the defendants' expenses; and the prosecution of said action has been stayed until such time as the security may be given.

4. Petitioner intends to appeal from said decision on the ground that § 61-b of the General Corporation Law of New York is contrary to the due process and equal protection clauses of the Fourteenth Amendment to the Constitution.

5. R. S. 14:3-15 of New Jersey is substantially identical with § 61-b of the General Corporation Law of New York. The full text of § 61-b appears in the brief submitted herewith. The decision of this Court regarding the constitutionality of R. S. 14:3-15 will therefore control the disposition of petitioner's appeal in his New York State Court action.

6. For the foregoing reasons, petitioner has a direct and immediate interest in the decision of the constitutional questions presented to this Court.

7. It is respectfully submitted that petitioner's *amicus curiae* brief, presented herewith, sets forth certain factual and statistical data having important bearing upon said constitutional questions. Such data, it is believed, has so far not otherwise been submitted to this Court.

8. The attorney for Hannah Cohen and David E. Cohen (petitioners in No. 442, respondents in No. 512), by letter submitted herewith, consents to the filing of the *amicus curiae* brief. John M. Harlan, Esq., the attorney for Beneficial Industrial Loan Corporation (respondent in No. 442, petitioner in No. 512), has been requested to consent, but has refused.

9. No previous application for the relief herein sought has been made.

10. The reason this petition is not verified by petitioner personally is that petitioner is not within the State of New York but in Florida, and his signature could not be obtained in sufficient time for the filing of this petition. Your deponent is a member of the Bar of the Supreme Court of the United States; he is one of the attorneys for petitioner in his above mentioned New York State Court action; and he is authorized to file this petition on behalf of petitioner.

WHEREFORE, it is respectfully requested that leave to file the *amicus curiae* brief submitted herewith be granted.

Dated, March 31, 1949.

JULIUS LEVY,
Attorney for Petitioner,
William B. Weinberger,
Office & P. O. Address,
295 Madison Avenue,
New York 17, N. Y.

State of New York }
County of New York } ss.:

Julius Levy, being duly sworn, says that he is the attorney for the petitioner in the above entitled action; that the foregoing petition is true of his own knowledge, except as to the matters therein stated to be alleged on information and belief, and that as to those matters he believes it to be true.

Deponent further says that the reason why this verification is not made by said petitioner is that he is not within the County of New York, which is the county where the deponent has his office.

Julius Levy.

Sworn to before me this
31st day of March, 1949.

Ethel Radix
Notary Public in the State of New York
Residing in Kings County
Kings Co. Clk. No. 23, Reg. No. 108-R-0
N. Y. Co. Clk. No. 268, Reg. No. 212-R-0
Commission expires March 30, 1950

Supreme Court of the United States

OCTOBER TERM, 1948

No. 142

HANNAH COHEN, Executrix of the Estate of SOL COHEN, deceased, and DAVID E. COHEN, Intervenor,

Petitioners,

vs.

BENEFICIAL INDUSTRIAL LOAN CORPORATION, *et al.*,

Respondents.

No. 312

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Petitioner,

vs.

HONORABLE WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey, *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR WILLIAM B. WEINBERGER AS *AMICUS CURIAE*

This brief is confined to the question whether § 14:3-15 of the Revised Statutes (Cum. Supp.) of New Jersey,*

* N. J. R. S. Cum. Supp. 14:3-15, N. J. S. A. 14:3-15, provides: "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having

generally and as applied to this case, is unconstitutional. We submit that the statute violates the due process and equal protection clauses of the Fourteenth Amendment to the Constitution.*

The jurisdictional and other formal recitals, as well as a statement of the facts, appear in petitioners' brief. To avoid repetition, the Court is respectfully referred thereto.

In short, R. S. 14:3-15 requires the plaintiff in a stockholder's derivative action, who owns less than 5% or $50,000 worth of his corporation's stock, to give security for the reasonable expenses, including attorneys' fees, which may be incurred by the corporation and the other defendants in the action. The security may from time to time be increased or reduced if it becomes inadequate or excessive.

Respondent here has demanded security in the sum of $125,000 (R. 9). While the Court below thought that "this estimate may well be taken with salt", it entertained "no doubt that the amount involved will be large" (R. 31).

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a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive."

Amendment XIV, § 1: " * * nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

Previous Authorities

R. S. 14:3-15 was modeled after § 61-b of the General Corporation Law of New York * (R. 51). While the constitutionality of the New York statute was sustained in *Lapchak* v. *Baker*, 298 N. Y. 89 (1948), the appellate review there was limited to the abstract question whether a stockholder-plaintiff may constitutionally be required to give security "in any amount whatever", however small or reasonable. Since here the Court below already held that the security will be "large", the *Lapchak* ruling is not pertinent.

In the lower New York courts § 61b was sustained in:

Shielcraut v. *Moffett*, 49 N. Y. S. 2d 64, aff'd 268 App. Div. 352 (two judges dissenting), rev'd on other grounds 294 N. Y. 180 (1945);

Baker v. *McFadden Publications, Inc.*, 270 App. Div. 440 (1st Dept., 1946, two judges dissenting), app. den. 270 App. Div. 840.

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* "§ 61-b. Security for expenses: In any action instituted or maintained in the right of any foreign or domestic corporation by the holder or holders of less than five per centum of the outstanding shares of any class of such corporation's stock or voting trust certificates, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to section sixty-four of this chapter, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter from time to time be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive" (22 McKinney's Consol. Laws of New York Annot., 1948 Supp., p. 76).

But the section was held invalid for violation of the due process and equal protection clauses of the Constitution in

Citron v. *Mangel Stores Corp.*, 50 N. Y. S. 2d 416 (1944).

The constitutionality and economic implications of § 61-b have been the subject of extensive discussion in the legal literature:

Zlinkoff, The American Investor and the Constitutionality of § 61-b of the New York General Corporation Law (1945), 54 Yale L. J. 352;

Hornstein, The Death Knell of Stockholders' Derivative Suits in New York (1944), 32 Calif. L. R. 123;

Hornstein, New Aspects of Stockholders' Derivative Suits (1947), 47 Columbia L. R. 1;

House, Stockholders' Suits and the Coudert-Mitchell Laws (1945), 20 N. Y. Univ. Law Quart. Rev. 377;

Jackson, Reorganization of the Corporate Concept (1944), 5 Corp. Reorg. and Amer. Bankruptcy Rev. 323;

Purcell, Foster and Hill (Practising Law Institute), Corporations: Enforcing the Accountability of Corporate Management and Related Activities of the S. E. C. (1946), pp. 11-17;

Carson, Further Phases of Derivative Actions (1944), 29 Cornell L. Q. 431;

Note (1944), 58 Harvard L. R. 135.

POINT I.

Due Process of Law.

No intelligent appraisal of the validity of a statute attacked on constitutional grounds is possible without analysis of the legal and factual setting in which it operates, the relevant social and economic conditions, the purposes

it is designed to accomplish and the practical results of its application. *Borden's Farm Products Co.* v. *Baldwin*, 293 U. S. 194, at 211, 213 (1934). Accordingly we shall discuss the useful and indeed indispensable functions heretofore performed by stockholders' derivative actions; their virtual destruction through the new statute without substitution of any other mode of relief; the immunity thereby secured to faithless corporate managements; and the complete absence of any reasonable relation between this radical destruction of stockholders' and corporations' rights and the evils which the statute was purportedly designed to cure.

A

Functions of the stockholder's derivative suit

Stockholders' derivative actions have been entertained in our Courts and those of England for more than a century. *Hichens* v. *Congreve*, 4 Russ. 562, 38 Eng. Rep. 917 (Ch. 1828); *Dodge* v. *Woolsey*, 18 How. (59 U. S.) 331, at 341-2 (1856); *Robinson* v. *Smith*, 3 Paige (N. Y.) 222 (1832). The eminent usefulness, nay, the absolute necessity of the stockholder's suit has been recognized even by those critical of its incidental abuses.*

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* *Havens* v. *Oakland*, 104 U. S. 450, at 453 (1882):

"The exercise of this power [of equity] in protecting the stockholder against the frauds of the governing body of directors or trustees, and in preventing their exercise, in the name of the corporation, of powers which are outside of their charters or articles of association, has been frequent, and is most beneficial, and is indisputed."

Isensee v. *Long Island Motion Picture Co.*, 184 Misc. 625, at 628 (1945):

"Stockholders' suits provide a wholesome remedy and often the only direct means of exposing mismanagement and corruption in the direction of corporate activities."

Shielcraft v. *Moffett*, *supra*, 49 N. Y. S. 2d. at 72 (quoting the "non-partisan Citizens Union"):

"In spite of abuses, minority stockholders' suits have been an effective means of holding large corporations in restraint and

The huge amounts of corporate moneys recovered from derelict fiduciaries in actions of this type bear witness to the essential function which the stockholder's suit performs in protecting the investing public. Nor are the actual dollars restored to corporate treasuries a full measure of the social benefits of stockholders' suits. In *Brendle* v. *Smith*, 46 F. Supp. 522, at 525-6 (D. C., S. D. N. Y., 1942), Judge Rifkind held:

> "Despite the numerous abuses which have developed in connection with such suits, they have accomplished much in policing the corporate system, especially in protecting corporate ownership as against corporate management. They have educated corporate directors in the principles of fiduciary responsibility and undivided loyalty. * * * *The measure of effectiveness of the stockholder's derivative suit cannot be taken by a computation of the money recovery in the litigated cases. The minatory effect of such actions has undoubtedly prevented diversion of large amounts from stockholders to managements and outsiders.*" (Italics added.)

But the stockholder's suit is not only a valuable, it is, in fact, "the *only* civil remedy that stockholders have for breach of fiduciary duty on the part of those entrusted with the management and direction of their corporations"; *Bayer* v. *Beran*, 49 N. Y. S. 2d 2, at 4 (1944, Shientag, J., italics added); *Shielcraft* v. *Moffett*, *supra*, 49 N. Y. S. 2d, at 71 (quoting Rosenman, J.). But for the stockholder's action, stockholders would be totally without redress for managerial wrongdoings. No court, no administrative agency would be open for their complaints.

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preventing them from wasting large sums of the stockholders' money for the benefit of a favorite few."

Carson, Current Phases of Derivative Actions Against Directors (1942), 40 Mich. L. R. 1125, at 1127:

> "It is clear that the stockholders' derivative suit is an absolutely necessary arm of equity jurisdiction and that, when used with justice and restraint, it has both public and private value."

More than that. The stockholder's suit, if it can be brought at all, is the only avenue of redress for the *corporation* itself. For a stockholder's suit lies only when the directors, in failing to seek redress, "are guilty of misconduct equivalent to a breach of trust; or where they stand in a dual relation which prevents an unprejudiced exercise of judgment": *United Copper Securities Co.* v. *Amalgamated Copper Co.*, 244 U. S. 261, at 264 (1917, Brandeis, J.); *Koral* v. *Savory, Inc.*, 276 N. Y. 215, at 218 (1937). The corporation thus has, by hypothesis, a valid cause of action against its faithless fiduciaries; it has the right to seek judicial relief; but the right is no more than theoretical since those in control of the corporation will not and cannot enforce it; and it must ultimately be barred by the statute of limitations. Unless a stockholder can intercede by derivative action, the corporation's right is nullified as certainly as though all right to relief were denied to the corporation in so many words.

B

The destruction of these rights by R. S. 14:3-15

1. *The amount of security:*

The statute does not limit the amounts of the attorneys' fees to be secured, except that they must be "reasonable". Security, even though "reasonable", may be prohibitive. The difficulties and complexities involved in many stockholders' actions are familiar. It is neither unusual nor unreasonable for the defendants in such actions to retain distinguished counsel. Stockholders' actions are ordinarily directed against several defendants, each of whom is entitled to counsel of his own choice. The anticipated aggregate "reasonable" charges of several prominent law firms for services in a protracted and intricate litigation are bound to be formidable (*Citron* v. *Mangel Stores Corp.*, *supra*, 50 N. Y. S. 2d, at 419). The amounts of security which have heretofore been required under § 61-b have

ranged from $5,000 to $75,000*; and experience indicates that defendants' expenses have repeatedly exceeded $100,000. *New York State Chamber of Commerce, Survey and Report Regarding Stockholders' Derivative Suits* (1944), p. 8 (hereinafter referred to as "*Chamber Report*").

Nor is this all. Under the statute the court is expressly empowered, at any stage of the proceedings before final judgment, to require further security. A stockholder able and willing to give security faces therefore the indefinite risk of putting up additional amounts, failing which he will be dismissed and forfeit his original bond.

2. *Prohibitive character of the security:*

This great burden is imposed by the statute not on every stockholder, but only on the small one. If the shares of the stockholder-plaintiff have a market value of no more than $50,000 and represent less than five percent of the corporation's outstanding capital stock, he must give security; and upon ultimate dismissal the security is applied to the payment of defendants' litigation expenses. But if his stock amounts to at least five percent or more than $50,000 worth, he may not be called upon to give security; and even if his suit is ultimately dismissed, he is under no liability for the defendants' attorneys' fees, *Isensee* v. *Long Island Motion Picture Co., supra*, 184 Misc., at 629.**

The paradoxical operation of R.S. 14:3-15 thus is to put a heavy financial burden on those stockholders who are least able to bear it, namely, the small ones; and to exempt those who could best afford it, namely, the large ones.

In the practical operation of the statute, the small stockholder will, of course, not furnish the security which he is

* Thus security of $75,000 was required, at the very eve of trial, in *Tichner* v. *Andreas*, (N. Y. County Clerk's Index No. 13696—1945), resulting in dismissal of the action.

** The Court below has held (R. 59) that this New York decision will presumably be followed in New Jersey.

called upon to give. In most instances he will lack the means. Even if he has them, his individual stake in the litigation will be insufficient to warrant the huge risk which R.S. 14:3-15 would impose on him. The average stockholder in the modern giant corporation holds but an infinitesimal fraction of the outstanding capital stock; and even the largest single stockholder therein may fall short of the five percent requirement of the statute.* The pro-

* Dispersion of stock ownership is well described in *Berle and Means, The Modern Corporation and Private Property* (1932), pp. 47-48:

> "As is to be expected, the process of stock dispersion has proceeded furthest in the very large companies. The stockholder lists of the largest railroad, Pennsylvania Railroad, the largest public utility, the American Telephone and Telegraph Company, and the largest industrial, the United States Steel Corporation, show in each case that the principal holder in 1929 owned less than one per cent of the outstanding stock. The most important holdings reported were, respectively, .34 of one per cent, .70 of one per cent, and .90 of one per cent. In these companies no single individual holds an important proportion of the total ownership. Even the aggregate holdings of the twenty largest stockholders of the Pennsylvania Railroad amounted in 1929 to only 2.7 per cent, of the Telephone Company to 4.0 per cent, and of the Steel Company to 5.1 per cent. Below the first twenty, the amount held by each stockholder dropped off rapidly to insignificant proportions. The twentieth holder of Railroad stock owned but .07 of one per cent, of Telephone stock .09 of one per cent, and of Steel stock but .09 of one per cent. The remainder of the half million Telephone stockholders, the 196,119 stockholders of the Railroad and the 182,585 holders of Steel stock were negligible as individual holders.
>
> "In the dispersion of stock these companies are in the lead but are not alone. In many large companies the largest stockholding represents a small proportion of the total ownership while the number of stockholders is legion."
>
> (There follows a list of fourteen corporations in which the size of the largest holding varies from 0.76% to 2.74%.)

For more recent statistics see: *Temporary National Economic Committee, Monograph 29* (1940), *The Distribution of Ownership in the 200 Largest Nonfinancial Corporations*, pp. 69 *et seq.*, 623 *et seq.* Of the 208 common stock issues analyzed, 74 were so distributed that no one stockholder held more than 5% (*ibid.*, p. 91).

portionate share of any individual stockholder in the proceeds of a successful derivative action is thus utterly out of proportion to his risk of loss, under the statute, if his suit should fail. For the average stockholders, whose proportionate beneficial interest in any corporate recovery is infinitesimal, it would be rank madness to furnish the statutory security.

Nor does the statutory exemption of stockholders owning $50,000 worth of shares afford appreciable relief. Recent studies disclose that individual stockholdings are not only infinitesimal in terms of percentages of the whole; they are also comparatively minute in terms of dollar values. It has been shown that the average block of any stock held by a single shareholder has a value of only $3,000; and of the fourteen million record stockholders in our key corporations, less than 2% own blocks worth $50,000 or more.* Such large stockholders as there are will often be identified with the management. The statutory exemption granted to $50,000 stockholders is thus without practical significance.

These conditions are illustrated by the dispersion of stockholdings in the respondent corporation, as shown in *Standard Corporation Descriptions*, published by *Standard & Poor's Corporation* (June, 1948, pp. 2397-9).** Respondent corporation had outstanding, as of December 31, 1947, 100,000 shares of preferred and 2,383,100 shares of common stock. The preferred stock may be ignored since it was issued in 1946, long after the transactions com-

* A recent analysis of the distribution of shareholdings discloses that the stocks of 1,710 key corporations are owned by about fourteen million record stockholders. 90% of all shareholdings analyzed had a value of less than $5,000; 96% had a value of less than $10,000; and 98% had a value of less than $50,000. *Temporary National Economic Committee, Monograph 30* (1941), *Survey of Shareholdings in 1710 Corporations with Securities listed on a National Securities Exchange*, p. 20; *Zlinkoff, supra*, 54 Yale L. J., at 367-8.

** Statistical information of this type is judicially noticed by this Court; see *Insurance Group Committee v. Denver & R. G. W. R. Co.*, 329 U. S. 607, at 617, fn. 6.

plained of (see Fed. Rule 23(b)). Of the common stock, respondent's parent, Beneficial Corporation, owned 882,000 shares, i.e., 37%. The remaining 1,500,000 common shares were held by about 17,000 stockholders, whose average holdings thus amounted to 88 common shares. In other words, the average common stockholder of respondent owns 0.003% of its outstanding common stock; and at an average market value of $25 per common share, the average block of common stock held by any one stockholder is worth $220.

It may thus readily be seen that R. S. 14:3-15 precludes the overwhelming majority of respondent's common stockholders from vindicating their own rights and those of their corporation.

3. *Impracticability of joining a sufficient number of stockholder-plaintiffs:*

To overcome the insuperable difficulty of furnishing the statutory security, Governor Dewey of New York made this suggestion:

> "Even if the stockholder owns a tiny percentage or $5,00 worth of stock, it should still be simple to bring an action without putting up security. If his action has any merit at all, it should be easy enough to interest others who do hold at least five percent or stock valued at $50,000". (Governor's Message accompanying his approval of § 61-b of the New York General Corporation Law; see 22 *McKinney's Consol. Laws of New York Annot.*, 1948 Supp., pp. 76-77).

Actually, however, this course is neither "simple" nor "easy"; on the contrary, it is quite as impracticable as giving the statutory security.

The wide dispersion of stock ownership in the large modern corporation has already been adverted to. The only practical means of enlisting the joinder of sufficient stockholders is by circularization. The names and addresses of stockholders can be garnered only from the

stock book of the corporation; the management will be none too eager to lay it open; and the courts have shown little inclination to assist the plaintiff in enforcing its inspection (see *Baker* v. *McFadden Publications, Inc.*, *supra*, 270 App. Div. 440).

Assuming this difficulty overcome, communication with the stockholders is exceedingly costly (*House*, *supra*, 20 N. Y. Univ. L. Quart. Rev., at 378). Taking into account that, to convince others of the merits of his claim, the soliciting stockholder must disclose his full charges, with all supporting evidence, and that he will have to reply to answers of the management, it is plain that the expense of enlisting the cooperation of other stockholders will equal, if not exceed, the cost of a bond required under R. S. 14:3-15.*

And what will be the effect of circularization? The extreme difficulty of inducing concerted action by stockholders of publicly-held companies, such as the respondent, is too familiar to require elaboration. See Professor (now Mr. Justice) *Douglas, Directors Who do not Direct* (1934), 47 Harvard L. R. 1305, at 1316. And this is not a case where stockholders are merely called upon to vote in favor of or against proposed corporate action. If the action is to be brought at all, the required number of stockholders must actually join therein. Many a stockholder, although persuaded of the merits of the case, will be reluctant to assume the expense, risk and annoyance of becoming a party plaintiff in a stockholder's action. In-

* It has been judicially recognized that the "dubiously effective medium of extensive newspaper advertisements aimed at rallying together scattered minority interests" is "almost prohibitively costly": *Delatour* v. *Meredith*, 144 F. 2d. 594, at 596 (C. C. A. 2, 1944). See also the testimony of Commissioner (now Mr. Justice) *Douglas*, *Hearings before House Judiciary Committee* on H. R. 6439 (amended and reported as H. R. 8406), 75th Cong., 1st Sess., 1937, 188. In one instance the cost to the minority interests of a closely fought proxy battle has been reported at $300,000: *Temporary National Economic Committee, Monograph No. 11, Bureaucracy and Trusteeship in Large Corporations* (1940), p. 20.

ability to join with others is thus obviously no gauge of the merits or demerits of the complaining stockholder's case.

But assume that a sufficient number of stockholders has been persuaded to take action. Will they really be able to meet the requirements of R. S. 14:3-15? The statute forestalls such possibility. For, simultaneously with the enactment of R. S. 14:3-15, the Legislature of New Jersey adopted a statute * which, like Rule 23 of the Federal Rules, requires the stockholder-plaintiff to show that he owned his shares at the time of the wrongs complained of. If any appreciable time elapses between the wrongs complained of and the institution of suit, the rapid turnover of stockholders in our publicly-held corporations will so narrow the number of stockholders qualified to sue as to make the requisite joinder impracticable.

Against this background of fact and law, we submit that the recommendation of joining with other stockholders sufficient to avoid the security requirement of R. S. 14:3-15 is hardly more than an empty gesture.

4. *Denial of the remedy is equivalent to destruction of the right:*

To recapitulate: In our large publicly-held corporations no one stockholder—unless identified with the management—owns five percent of the outstanding stock; the average stockholder owns only a small fraction of one percent. Ninety-eight percent of the stockholders own less than $50,000 worth of stock. For the small stockholder it is impossible or impracticable to furnish the

* Chapter 131, Laws of 1945, § 2 (New Jersey), provides: "In any action, suit or proceeding brought or maintained in the right of a domestic or foreign corporation by the holder or holders of shares or of voting trust certificates representing shares of such corporation, it must be made to appear that the complainant was a shareholder or the holder of a voting trust certificate at the time of the transaction of which he complains or that his share or voting trust certificate thereafter devolved upon him by operation of law."

security required by the statute or to join with the requisite number of other stockholders. The plain effect, if not the purpose of R. S. 14:3-15 thus is to bar the corporation and its stockholders from any redress for the misconduct of those in control.

Experience demonstrates the lethal effect of the statute. Since the enactment of § 61-b in New York, the stockholder's suit has become virtually extinct. The number of cases involving widely-held corporations instituted in New York County, for example, has fallen from an average of over fifty to two per year (*Hornstein, supra*, 47 Col. L. R., at 12). If it was the intention of the framers of the statute to abolish the stockholder's suit in publicly-held corporations, the objective has been marvelously accomplished.

Such legislative destruction of every remedy deprives the corporation as well as its stockholders of their property rights.* "Want of right and want of remedy are the same

* That the corporation's cause of action against its fiduciaries is property protected by the Constitution is too plain for argument. *Pritchard* v. *Norton*, 106 U. S. 124, at 132 (1882); *Ettor* v. *Tacoma*, 228 U. S. 148, at 156 (1913); *Forbes Pioneer Boat Line* v. *Everglades Drainage District*, 258 U. S. 338, at 340 (1922, Holmes, J.); *Graham* v. *Goodcell*, 282 U. S. 409, at 426 (1931).

The property rights of the stockholder are equally clear. True, the cause of action belongs primarily to the corporation and the stockholder is deemed only the "instigator" of the suit. However, the stockholder has an undivided equitable property right in the corporation's cause of action, *Pollitz* v. *Gould*, 202 N. Y. 11, at 15 (1911). He is "the equitable owner of an undivided fractional part of the entire assets of the company", *Flynn* v. *Brooklyn City R. Co.*, 158 N. Y. 493, at 504 (1899). The stockholder-plaintiff in a derivative suit thus is not a mere volunteer. He has "a real interest", *Ashwander* v. *Tennessee Valley Authority*, 297 U. S. 288, at 318 (1936). "It is only because the stockholder has an interest in the subject matter that he is allowed, when the directors will not pursue the guilty persons, or when they are themselves the alleged guilty persons, to bring the action himself"; *Ithaca Gas-Light Co.* v. *Treman*, 30 Hun (N. Y.) 212, at 213 (3rd Dept., 1883). Or, as it was recently put in *Goldstein* v. *Groesbeck*, 142 F. 2d 422, at 425 (C. C. A. 2, 1944); cert. den. 323 U. S. 737:

> "a shareholder's suit in essence is nothing more than a suit by a beneficiary of a fiduciary to enforce a right running to the fiduciary as such."

thing", *Edwards v. Kearzey*, 96 U. S. 595, at 600 (1878). Or, in the words of Mr. Justice Cardozo,

> "statutes which take away every remedy for past wrongs, as distinguished from statutes which merely change the remedy, are condemned as unconstitutional. The destruction of every remedy destroys the cause of action".
>
> *Jacobus v. Colgate*, 217 N. Y. 235, at 241-2 (1916).

For constitutional purposes it makes no difference that the remedy is destroyed by indirection rather than by outright repeal. "The State cannot escape its constitutional obligations by the simple device of denying jurisdiction in such cases to courts otherwise competent". *Angel v. Bullington*, 330 U. S. 183, at 188 (1947). To permit legal action in form, but to require prohibitive security as a condition precedent, is tantamount to barring it altogether. Thus in *Broderick v. Rosner*, 294 U. S. 629, at 640 (1935, Brandeis, J.), a state statute requiring that substituted process in an action be served upon many thousands of individuals was struck down because of the prohibitive expense entailed. In *Ex parte Young*, 209 U. S. 123, at 147 (1908), this Court held that "when the remedy is so onerous and impractical as to substantially give none at all, the law is invalid, although what is termed a remedy is in fact given". Broadly speaking, "penalties imposed on one party for the privilege of appeal to the courts deterring him from vindication of his rights, have been held invalid under the 14th Amendment": *Chicago & N. W. R. Co. v. Nye Schneider Fowler Co.*, 260 U. S. 35, at 47 (1922); *Missouri P. R. Co. v. Tucker*, 230 U. S. 340, at 348-351 (1913).

We submit that R.S. 1433-15 deprives petitioners here as well as the respondent corporation of their property.

5. Immunity to faithless corporation managements.

The effect of statutes such as § 61-b and R.S. 14-3-15 upon the economic system of this country is incalculable. Publicly-held corporations own the bulk of this country's industrial wealth; they own a large fraction of its total wealth; they control the major part of its industrial resources and its financial apparatus.* In this huge segment of our economy, ownership and control are sharply divorced. Ownership is dispersed among many millions of stockholders who have no effective voice in the management of their properties. Control rests with the corporate managements whose ownership interest in the properties entrusted to them is minute.** A large portion of our national wealth is thus managed by a small number of fiduciaries for a large number of absentee owners.

In a system such as this some effective means of judicial control over the fiduciaries occupying such pivotal positions is indispensable. Fiduciary rights without fiduciary accountability are unthinkable. A statute in effect absolv-

* "In 1909 the two hundred largest non-financial corporations held approximately a third of the assets of all such corporations. By 1930 over half of the assets were so owned. In 1933 the physical assets of the two hundred giants constituted about sixty percent of all those held by non-financial corporations, about half of the total industrial wealth, or about a fifth of the total national wealth." *Temporary National Economic Committee, Monograph 11, Bureaucracy and Trusteeship in Large Corporations* (1940), p. 4; *National Resources Committee, The Structure of the American Economy* (1939), I, 106-7.

** *Temporary National Economic Committee, Monograph 11, supra*, pp. 11, 12:

"* * * in approximately half of these companies the combined holdings of all members of the management and other important stockholders total only about five percent, while in more than fifteen cases did such total holdings constitute a majority of the potential votes.

"In half of the thirty-six Railroads examined the officers held not more than four-hundredths of one percent (the median) of the voting power. The corresponding percentages for public utilities and industrials are 0.17 and 1.38, respectively."

ing the fiduciaries from their legal responsibility would cut off the very roots of the economic structure of this nation.

R.S. 14:3:15 is such a statute. The stockholder's suit is the only avenue of redress not only for the stockholders, but for the corporations themselves against unfaithful managements in control of the corporations; and the threat of such suits is the only sanction restraining corporate fiduciaries otherwise free from any control or curb. The statute in effect destroys that remedy without substituting another. It stays the arm of justice from giving any protection to our publicly-held corporations and their stockholders. By thus extending immunity to corporate managements, it not only encourages them, but gives them complete license to disregard their duties and to deal with the properties entrusted to them as their uncontrolled self-interest may dictate. Such denial of right and remedy in the most important field of our economic life runs counter, we believe, to fundamental constitutional safeguards.

C

Denial of due process

It is elementary that the constitutional protection of property rights is not absolute. "Where the public interest is involved, preferment of that interest over the property interest of the individual, to the extent even of its destruction, is one of the distinguishing characteristics of every exercise of the police power which affects property"; *Miller* v. *Schoene*, 276 U. S. 272, at 279-280 (1928). But the police power, in turn, cannot be expanded to a degree that private property disappears; *Pennsylvania Coal Co.* v. *Mahon*, 260 U. S. 393, at 415 (1922, Holmes, J.). As stated by Mr. Justice Brandeis, "the police power is subject to the constitutional limitation that it may not be exerted arbitrarily or unreasonably"; *Nashville, C. & S. L. R. Co.* v. *Walters*, 294 U. S. 405, at 415 (1935). And

see *Daniel v. Family Security Life Ins. Co.*, U. S. 93 L. Ed. (adv.) 483, at 486 (1949).

We submit that R.S. 14:3-15 fails to meet this test of reasonableness.

1. *The purposes of the statute:*

In the absence of legislative hearings or findings, the objectives of § 61-b and R.S. 14:3-15 must be gathered from the gubernatorial messages accompanying them and from the Report of the New York State Chamber of Commerce which is the fountainhead of the new statutes. The messages and the Report describe the evils allegedly incident to stockholders' litigations. The existence of some of those abuses is not disputed; but their extent and the reasonable relation of the statutes to their cure is a different question.

(a) *Baseless Suits:*

The primary purpose of R.S. 14:3-15, as found by the Court below, was "to prevent losses to both domestic and foreign corporations and their stockholders by unjustified litigation" (R. 45). The assumed prevalence of unfounded stockholders' suits, which underlies this statement, is apparently predicated upon the statistics compiled in the Chamber Report. But those statistics are inconclusive and misleading; and the statute bears no reasonable relation to the pretended evil.

The Chamber Report surveys the incidence of stockholders' suits in New York and Kings County during the ten-year period from 1932 to 1942. Only 0.27% of all actions filed in New York County were stockholders' suits (1128 out of 421,417); and in Kings County the percentage was 0.16% (142 out of 86,840) (*Chamber Report*, p. 3). Only 573 out of these 1266 stockholders' actions involved publicly-held corporations (*Chamber Report*, p. 6). These figures would hardly support any thesis that minority stockholders' suits constitute an undue burden on the courts.

Out of the 573 actions involving publicly-held corporations, 10% resulted in actual corporate recoveries through judgment or court-approved settlements.* Whether this record of success is "good" or "bad" must depend upon its comparison with other types of litigation. It is a matter of common knowledge that only a small percentage of any type of actions reaches the stage of actual trial. In New York County, less than 5% of all suits, including commercial and tort actions of all kinds, reach trial (*McCook, J., Fourteen Years of Judicial Service*, 1933, p. 152). It should, therefore, be no cause for surprise that the stockholders' suits fared little better.

The Chamber Report completely fails to elucidate the grounds for which pre-trial discontinuances or dismissals have occurred in the derivative cases analyzed by it. This Court knows that stockholder litigation is "met with every obstacle and procedural delay that ingenuity of skilled counsel can devise"; *Dresdner* v. *Goldman Sachs T. Corp.*, 240 App. Div. 242, at 245 (2nd Dept., 1934). An examination of the results of those derivative actions in which issue was joined is therefore pertinent. Sixty-two percent of those cases resulted in corporate recoveries.** This, we submit, would seem to be no mean record of success.

But let it be assumed, contrary to actualities, that there exists a prevalence of unfounded actions in the derivative field. What relation does the statute bear to this evil?

* The *Chamber Report* (p. 6) lists recoveries in 13 cases; court-approved settlements in 33 cases, dismissals in 215 cases, private settlements in 60 cases and discontinuances in 155 cases, while 54 were pending and 43 showed no record disposition. Eliminating the last-mentioned 97 cases, it appears that 46 out of 476 cases, or 10%, resulted in corporate recoveries.

** *Your Investments* (American Investors Union), March, 1944, p. 27, finds

> "171 (stockholders') cases in which issues were joined. Out of this number there were 43 recoveries and 93 settlements, while only 65 suits were won by the defendants. In other words, 106 out of 171 suits were won by stockholders, or sixty-two percent of the cases involved."

Obviously, no stockholder will bring a clearly unfounded action unless he can hope for some kind of reward. A baseless derivative action will therefore be brought only in the hope that the plaintiff will be bought off for the nuisance value of his suit. The expectation of a "private settlement" is the only objective which can motivate a baseless derivative action.

Not the stockholder's suit as such, but the possibility of privately settling it is thus the root of the evil. Eliminate the private settlement, and you eliminate the "racket" of unfounded derivative actions. Had the Legislature really been concerned with the true abuse of stockholders' suits, the extortionate secret settlement, the remedy was painfully obvious: To bar secret settlements. This patent solution has been successfully adopted by Rule 23(c) of the Federal Rules.

R.S. 14:3-15 does not touch the private settlement. Instead of curing the evil, it kills the patient. For the statute bars not only the baseless, but equally the well-founded stockholder's suit. On a motion for security under the statute, "the merits of the action are not * * * before the Court" (*Shielcraut* v. *Moffett, supra*, 49 N. Y. S. 2d, at 70). No matter how meritorious the plaintiffs' case, no matter how clear the guilt of the defendants, the complaint can and will be silenced. The complete disregard of the statute for the merits of the action which it strikes down is one of the most obnoxious features distinguishing it from earlier similar enactments.* The statement that R.S. 14:3-15 is aimed only at "irresponsible strike suits" is thus without substance.

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* See, e.g., § 70 of the Patent Act, 35 U. S. C. § 70; § 9(e) of the Securities Exchange Act, 15 U. S. C. § 78i(e); § 282 of the Surrogate's Court Act of New York; and the following cases concerning them:

Fischer v. *Karl*, 6 F. R. D. 268, at 269 (D. C., E. D. N. Y., 1946);

Acker v. *Schulte*, 74 F. Supp. 683, at 688-690 (D. C., S. D. N. Y., 1947);

Re Pelcyger's Estate, 171 Misc. 1016 (1939);

Re Bray's Estate, 27 N. Y. S. 2d, 549 (1941).

(b) *Private Settlements of Well-Founded Actions:*

In further support of the statute, Governor Dewey's message stated:

> "Worse yet, many suits that were well based, have been brought not in the interest of the corporation or of its stockholders, but in order to obtain money for particular individuals who had no interest in the corporation or its stockholders. Secret settlements—really pay-offs for silence—have been the subject of common suspicion" (R. 46).

An amazing argument! "Many suits", it is conceded, "were well based". The guilty defendants bought silence by paying off the plaintiffs. Assuredly, such buy-offs are an evil calling for legislative action; for they prevent the return to the corporation of the moneys diverted by its unfaithful fiduciaries. A statute addressed to this abuse might be expected to make sure that justice will henceforth be done; that the "well based" action will be prosecuted to recovery for the corporation; and that it will not be thwarted by private settlement. But, strange to say, R.S. 14:3-15 does exactly the opposite. It makes sure that justice will *not* be done. Under the statute the stockholder's action, although "well based", is stifled at its very inception. The court is now forced to do what the wrongdoer heretofore achieved through the private pay-off: The diversion of the corporation's assets remains without redress and the wrongdoers enjoy perpetual immunity.

We submit that the evil of private settlements of "well-based" stockholders' suits is not "cured" by barring those suits altogether.

2. *Lack of Reasonableness of the Statute:*

It may be conceded that, by in effect abolishing the stockholder's action, the statute does away with the alleged abuses incident thereto. If no stockholder's action at all can be brought, none will be instituted that is unfounded, and none will be abused for an extortionate settlement.

But the cure is too radical to bear a reasonable relation to the evil. To illustrate: Much abuse has been inherent in the prosecution of personal injury actions. To deal with them would be a legitimate objective of the police power. A statute abolishing all relief for personal injury would radically eliminate the abuses. But we find it hard to believe that such drastic step would find constitutional sanction. R.S. 14:3-15 closely parallels such hypothetical statute.

Needless to say, no particular sanctity inheres in the stockholder's derivative action. If that mode of relief be thought inappropriate or dangerous, others may be prescribed by the Legislature in its place. But nothing of the kind was done; and we seriously question the right of a state, under the Constitution, to invite the public at large to invest its funds in corporate enterprises; to entrust the management of their property to the directors and executives of such corporations; and at the same time to deny the investor any effective right against the managerial diversion of his property.

To say that the evils envisaged by the Legislature could have been cured by less stringent means—such as the prohibition of private settlements or a preliminary judicial appraisal of the merits of the proposed stockholder litigation—raises more than a mere question of legislative wisdom. The existence of less drastic legislative cures has a direct bearing on the issue whether the absolute destruction of property rights of corporations and stockholders is "reasonably necessary for the accomplishment of the purpose (of the statute), and not unduly oppressive upon individuals", *Lawton* v. *Steele*, 152 U.S. 133, at 136-7. It is no answer that Legislatures are "laboratories for legislation" and that "early experiments are rarely perfect" (R. 55). Unless the due process clause of the Fourteenth Amendment, as applied to property rights, is to be deprived of all vitality, even an "experiment" must be subjected to the test of reasonableness.

In this case the evil of unfounded stockholders' suits and improper private settlements could have been dealt with by

limited legislative measures adapted to those very evils. The Legislature, instead, adopted a system which virtually abolished all effective legal protection of stockholders and corporations against their faithless fiduciaries and granted the latter complete and uncontrolled freedom from responsibility. If that be a legitimate objective of the state's police power, we know of no precedent so holding.

3. *Access to Court and Due Process:*

But it is not even necessary to debate the constitutional validity of R.S. 14-3-15 in the light of a generalized rule of reason limiting the state's exercise of its police power. For the special problem here involved, namely, the state's power to impede a litigant's access to the courts through the imposition of liability for counsel fees, has been the frequent subject of adjudication by this Court. The cases are listed in the footnote; their substance may be summarized as follows:

Common carriers, insurance companies and similar institutions had adopted the practice of delaying or refusing the payment of claims against them in the hope that the necessity of litigation might discourage the claimants from enforcing the full amount of their rights. In order to prevent such practices several states enacted statutes re-

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* *Life & Casualty Ins. Co.* v. *McCray*, 291 U. S. 566 (1934); *Dohany* v. *Rogers*, 281 U. S. 362 (1930); *Sioux County* v. *National Surety Co.*, 276 U. S. 238 (1928); *Chicago & N. W. R. Co.* v. *Nye Schneider Fowler Co.*, 260 U. S. 35 (1922); *Atchison T. & S. F. R. Co.* v. *Vosburg*, 238 U. S. 56 (1915); *Missouri Pac. R. Co.* v. *Larabee*, 234 U. S. 459 (1914); *Missouri K. & T. R. Co.* v. *Harris*, 234 U. S. 412 (1914); *Missouri K. & T. R. Co.* v. *Cade*, 233 U. S. 642 (1914); *Kansas City S. R. Co.* v. *Anderson*, 233 U. S. 325 (1914); *Chicago M. & S. P. R. Co.* v. *Polt*, 232 U. S. 165 (1914); *St. Louis I. M. & S. R. Co.* v. *Wynne*, 224 U. S. 354 (1912); *Seaboard Airline R. Co.* v. *Seegers*, 207 U. S. 73 (1907); *Farmers & M. Ins. Co.* v. *Dobney*, 189 U. S. 301 (1903); *Fidelity Mutual Life Ass'n* v. *Mettler*, 185 U. S. 308 (1902); *Atchison T. & S. F. R. Co.* v. *Matthews*, 174 U. S. 96 (1899); *Gulf, C. & S. F. R. Co.* v. *Ellis*, 165 U. S. 150 (1897).

quiring the companies to pay to successful claimants their reasonable attorneys' fees and a penalty. Counsel fees and penalties awarded under these statutes were, in most instances, moderate in amount, aggregating a few hundred dollars. In dealing with the constitutional validity of the statutes, this Court laid down this test: If they operated only as a stimulus to discourage delays by the companies in the payment of claims, the statutes were valid. But if they were such as to deter the companies from vindicating their rights, through the imposition of an excessive penalty for resorting to the courts, the statutes were invalid. In the leading case of *Chicago N. R. Co.* v. *Nye Schneider Fowler Co., supra*, 260 U. S. 35, this Court thus summarized the law:

> "In this scrutiny of the particular operation of a statute of this kind, we have sustained it in its application to one set of facts by the state court, and held it invalid when applied to another * * *" (p. 44).
>
> "This penalty or stimulus may be in the form of attorneys' fees. But it is also apparent from these cases that such penalties or fees must be moderate and reasonably sufficient to accomplish their legitimate object, and that the imposition of penalties or conditions that are plainly arbitrary and oppressive, and 'violate the rudiments of fair play' insisted on in the 14th Amendment, will be held to infringe it" (p. 44).
>
> "Penalties imposed on one party for the privilege of appeal to the courts deterring him from vindication of his rights, have been held invalid under the 14th Amendment. Missouri P. R. Co. v. Tucker, 230 U. S. 340. While the present case does not involve any such penalties as were there imposed, we think the principle applies to the facts of this case" (p. 47).

The same rule was laid down by Mr. Justice Cardozo in *Life & Casualty Ins. Co.* v. *McCray, supra*, 291 U. S. 566, at 574-5:

> "It is all 'a question of more or less'. Sexton v. Kessler & Co., 225 U. S. 90, 98. The price of error

may be so heavy as to erect an unfair barrier against the endeavor of an honest litigant to obtain the judgment of a court. In that event, the constitution intervenes and keeps the courtroom open. Ex parte Young, 209 U. S. 123; Wadley Southern R. Co. v. Georgia, 235 U. S. 651, 661, 662. On the other hand, the penalty may be no more than the fair price of the adventure. St. Louis, I. M. & S. R. Co. v. Williams, 251 U. S. 66. In that event, the litigant must pay for his experience, like others who have tried and lost."

The constitutional issue thus being reduced to "a question of more or less", we submit that the present case plainly is one of "more". Respondent has asked for a security of $125,000; and the Court below has recognized that the security will be "large" (R. 51). No comparable sum was involved in any of the cases decided by this Court. A statutory fine of $5,000 was struck down in *Ex parte Young, supra,* 209 U. S. 123, as foreclosing access to the court. Liquidated damages of $500 were held unconstitutional for the same reason in *Missouri P. R. Co. v. Tucker, supra,* 230 U. S. 340. The large liability which must be imposed on the present plaintiffs under the statute is so clearly and unmistakably prohibitive as to make further analysis of the authorities superfluous.

However, it is not only the *amount* of liability to be imposed on plaintiffs which places this case beyond the line drawn by this Court. In all previous cases reaching this Court the penalty was exacted only from a litigant who had lost and was thus adjudicated to be wrong. But these plaintiffs must raise a large security before they have even a chance to demonstrate the merits of their claim. These plaintiffs are thus not penalized for asserting an unjust claim. The statute is indifferent to the justice of their cause. Right or wrong, they cannot sue at all.

Worse than that. Even if plaintiffs were to give the security, they would have no assurance of retrieving it, even though they could prove their case to the hilt. For R. S. 1413-15 expressly authorizes the court to increase the security at any time before final judgment; if plaintiffs

are unable to give the additional security they will be dismissed and lose their original deposit. And they forfeit it not because of any lack of merit in their cause of action, but only because of the additional tax imposed upon them by the statute. R. S. 14:3-15 thus introduces this revolting innovation: Plaintiffs must pay their adversaries' counsel fees (out of their initial bond), not because their claim is unjust but because they are unable to back their claim with the unlimited further stakes envisaged by the statute.

We submit that "a judicial review beset by such deterrents does not satisfy the constitutional requirements"; *Oklahoma Operating Co. v. Love*, 252 U. S. 331, at 337 (1920, Brandeis, J.). Granted that "the Fourteenth Amendment does not prohibit the award of an attorney's fee, *moderate in amount*" (*Life & Casualty Ins. Co.* v. *McCray, supra*, 291 U. S., at 569, Cardozo, J., italics added); but the liability imposed on these plaintiffs will not be "moderate in amount", it will be prohibitive. Granted that "'the *unsuccessful* defendant must pay the adversary's costs" which "may include the fees of an attorney" (*Life & Casualty Ins. Co.* v. *McCray, supra*, italics added); but these plaintiffs are subjected to an unsupportable financial imposition regardless even of prospective merits; and they may have to forfeit their bond not only if they are ultimately "unsuccessful", but, despite impending success, if they are unable to meet additional security requirements. Such a statute, we believe, "violates the rudiments of fair play". It deprives plaintiffs of their cause of action. It deprives respondent itself of its cause of action. It exposes the corporate property to the grasp of an unfaithful management, without chance of redress. A statute such as this, we submit, offends the elements of due process required by the Constitution.

POINT II

Equal Protection of the Laws.

We contend that R. S. 14:3-15 denies to plaintiffs the equal protection of the laws, in violation of the Fourteenth Amendment to the Constitution.

1. R. S. 14:3-15 requires security from the small stockholder, but not from the large. A stockholder whose shares constitute less than 5% of the corporation's stock and have a value of less than $50,000 is subject to the statute. But one holding more than 5% or $50,000 worth of stock is exempt. It is not commonly thought in this country that bigness, as such, should be rewarded by special legislative privileges and that the small man, as such, should be subjected to special disabilities in public life. This view has, so far, also prevailed in the field of derivative suits; *Ashwander* v. *Tennessee Valley Authority*, 297 U. S. 288, at 318 (1936); *Everett* v. *Phillips*, 288 N. Y. 227, at 233 (1942).

2. Of course, it is elementary that equal protection does not forbid classification. But the classification, in order to be valid, "must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike"; *Frost* v. *Corporation Commission*, 278 U. S. 515, at 522 (1929). Or, as the rule was phrased recently in *Asbury Hospital* v. *Cass County*, 326 U. S. 207, at 214 (1945):

> "The legislature is free to make classifications in the application of a statute which are relevant to the legislative purpose. The ultimate test of validity is not whether the classes differ, but whether the differences between them are pertinent to the subject with respect to which the classification is made."

What relation then does the differentiation between large and small stockholders bear to the objectives of R. S. 14:3-15?

3. If R.S. 14:3-15 imposed equal liabilities on large and small stockholders, while requiring the small alone to give advance security, such differentiation might perhaps be justified by the presumably inferior financial responsibility of the small stockholder. Such, however, is not the statutory scheme. R.S. 14:3-15 discriminates not only in respect to *security*, but by imposing altogether different *liabilities* on large and small stockholders. The small stockholder must not only secure his adversaries' counsel fees; he must, if unsuccessful, pay them. The large stockholder is not only exempted from giving advance security; but he is, even if unsuccessful, under no liability for his adversaries' counsel fees (*supra*, p. 8). The hypothesized lack of financial means of the small stockholder certainly does not justify his being saddled with a greater burden of ultimate expense.

4. Nor does the discrimination against small stockholders bear any reasonable relation to the statute's purpose of eliminating baseless derivative suits. For the small stockholder, as defined in the statute, may have a palpably and undeniably meritorious case, and yet the statute bars him from relief by the requirement of security in a prohibitive amount. On the other hand, a large stockholder may bring a suit utterly lacking in merit, without hope of success and with an unworthy motive and malicious design; yet, no security may be exacted and, upon an adverse determination, he is not liable for more than the ordinary statutory costs applicable to all litigants. Unless the rights of a small claimant be conceived as presumably unfounded, and those of the large claimant as presumably meritorious, there is no basis for admitting one and excluding the other.

It has been said that the majority of stockholders' suits in publicly owned corporations have been brought by small shareholders. Small wonder, since the overwhelming majority of all shareholders in such corporations is small, and the few large ones are often identified with the management. Does it follow that the small stockholder's suit is presumptively unfounded?

It has further been suggested that self-interest will deter the large, but not the small stockholder from bringing a baseless derivative suit. For such a suit, it is argued, will involve the corporation in substantial expense; the corporate expenses would impair the value of a large block of stock more seriously than that of a small block; the large stockholder will, therefore, be more reluctant to involve the corporation in a reckless derivative litigation. The inference seems to be that the small stockholder, less restrained by self-interest than the large, may properly be singled out for legislative regulation.

However, the purported difference in the degree of self-restraint between large and small stockholders is completely lacking in substance. Whether a baseless derivative action be brought by a $10,000 stockholder in a $1,000,000 corporation, or by a $50,000 stockholder in a $5,000,000 corporation, the value of plaintiff's stock would in each case be reduced by precisely the same amount, i.e., one percent of the corporation's litigation expenses. The motives of self-interest, counseling against the institution of suit, would thus in both instances have precisely the same weight. And yet the plaintiff in the first case would, under the statute, have to give security, while the plaintiff in the second case would be exempt.

Even where the impact of corporate expenses would affect the large stockholder more extensively than the small one, the amounts involved are altogether too insignificant to justify legislative differentiation. Take the instant case. If this action were brought by a $50,000 stockholder, his proportionate share of respondent's pros-

pective litigation expenses would amount to $84.* This paltry sum, less than the ordinary taxable costs and disbursements, cannot possibly operate as a deterrent discouraging a "large" stockholder from instituting a baseless derivative action. The alleged differences of interested self-restraint thus bear no "fair and substantial relation" to the statute's discrimination between small and large stockholders.

Statistics, rather than speculation, would seem to furnish the most reliable test to determine the comparative merits of derivative suits brought by large and small stockholders, respectively. The only statistics available are those of the *Chamber Report* which can hardly be claimed to be partial to the small stockholder. Here is what the *Chamber Report* shows (p. 32):

In the case of *closely held corporations* (where the complaining stockholder presumably owns a comparatively large percentage of the outstanding stock), *five percent* of all derivative actions brought resulted in a corporate recovery. In the case of *publicly held corporations* (in which the complaining stockholder presumably owns a very small percentage of the outstanding stock), *eight percent* ** of all the derivative actions brought resulted in a corporate recovery (2% through judgments, 6% through court-approved settlements). This record, we submit, speaks for itself. It refutes any theory that a small stockholder's action may more readily be presumed to be baseless than that of a large stockholder.

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* The average value of respondent's common stock in 1947 was $25 per share (today's price: 23½). Thus a stockholder owning 2,000 common shares of respondent would meet the $50,000 test and be exempt from security. Since approximately 2,383,000 common shares of respondent are outstanding (*supra*, p. 10), such a stockholder would, in case of failure, have to bear 2,000/2,383,000, or 0.084% of respondent's litigation expenses. On the somewhat extravagant assumption that these expenses might amount to $100,000, the proportionate share thereof to be borne by a $50,000 stockholder-plaintiff would amount to $84.

** More accurately: 10% (*supra*, p. 19).

5. Another avowed purpose of the statute is the elimination of the secret private settlement of meritorious actions. But what relation does this objective bear to the differentiation between large and small stockholders? Large stockholders, and those allied with them, are equally as small ones apt to prefer their individual advantage to that of the corporation. Experience does not indicate that the standards of ethics and good moral conduct are higher among large than among small stockholders. Again the statistics of the *Chamber Report* shatter the rationale apparently underlying the statute's discrimination. Of all derivative actions brought on behalf of *closely held corporations,* fully *twenty-eight percent* were privately settled. Of all derivative actions brought on behalf of *publicly held corporations,* only *ten percent* were privately settled (*Chamber Report,* p. 32). Again, the record speaks for itself. If experience be a test at all, large stockholders are more amenable to the temptation of the private settlement than small ones.

6. Not only do we thus fail to find any "fair and substantial relation" between the objectives of R.S. 14:3-15 and its differentiation between large and small stockholders; but it may be added that discrimination based on wealth or poverty has traditionally been considered as particularly odious. This view was forcefully stated by Mr. Justice Brewer in *Gulf, C. & S. F. R. Co.* v. *Ellis,* 165 U. S., at 155 (1897):

> "But it is said that it is not within the scope of the 14th Amendment to withhold from states the power of classification, and that if the law deals alike with all of a certain class it is not obnoxious to the charge of a denial of equal protection. While, as a general proposition, this is undeniably true (citing cases), yet it is equally true that such classification cannot be made arbitrarily. The state may not say that all white men shall be subjected to the payment of the attorneys' fees of parties successfully suing them, and all black men not. It may not say that all men beyond a certain age

shall be alone thus subjected, or *all men possessed of a certain wealth*. These are distinctions which do not furnish any proper basis for the attempted classification." (Italics added.)

R.S. 14:3-15 does almost precisely what this Court said a state cannot do. And it does so in a particularly objectionable fashion. If wealth or poverty could furnish any basis at all for differentiation, the greater resources of the rich might justify their subjection to greater burdens. But R.S. 14:3-15 reverses logic, fairness and justice. The small stockholder, presumably lacking in means, is subjected to a huge imposition; the large stockholder, who might be better able to bear it, is left scot-free. The statute, we submit, bears all the earmarks of "invidious discrimination", *Queenside Hills Realty Co.* v. *Saxl*, 328 U. S. 80, at 85 (1946), which make it obnoxious to the Fourteenth Amendment, *Skinner* v. *Oklahoma ex rel. Williamson*, 316 U. S. 535, at 541 (1942).

We have recently been reminded that "equal protection of the laws is something more than an abstract right. It is a command which the state must respect, the benefits of which every person may demand. Not the least merit of our constitutional system is that its safeguards extend to all—the least deserving as well as the most virtuous." *Hill* v. *Texas*, 316 U. S. 400, at 406 (1942). We believe that a statute more flagrantly violating these precepts than R.S. 14:3-15 is hard to conceive.

Dated: New York, March 29, 1949.

Respectfully submitted,

JULIUS LEVY,
Attorney for William B. Weinberger, amicus curiae.

WILLIAM E. HAUDEK,
on the Brief.

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Supreme Court of the United States

OCTOBER TERM, 1948.

No. 442

442

HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenor,

Petitioners,

against

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Respondent,

and

O. W. CASPERSON, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. A. SMITH, E. L. KENCAID, ALBERT G. MORHART, RAYMOND D. SHEPPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAUL A. SEIBOLD, Individually,

Defendants.

No. 512

512

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Petitioner,

against

Honorable WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey; and HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenors,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

MOTION AND BRIEF OF LEWIS M. DABNEY, JR. AS *AMICUS CURIAE.*

LEWIS M. DABNEY, JR.,
Amicus Curiae,
61 Broadway,
New York 6, N. Y.

Supreme Court of the United States

OCTOBER TERM, 1948.

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Honorable WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey; and HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenors,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Motion for Leave to File Brief as *Amicus Curiae*.

To The Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The undersigned, as an attorney of this Court, respectfully moves this Honorable Court for leave to file the accompanying brief as *amicus curiae*.

Counsel for petitioners have consented to the filing of this brief. Counsel for respondents have been requested to consent, but have refused.

April 15, 1949.

LEWIS M. DABNEY, JR.,
Amicus Curiae.

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 442.

HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenor,

Petitioners,

against

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Respondent,

and

O. W. CASPERSON, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAUL A. SEIBOLD, Individually,

Defendants.

No. 512.

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Petitioner,

against

Honorable WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey; and HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenors,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF OF *AMICUS CURIAE.*

Questions of constitutionality and appealability aside, this case presents the simple issue of whether, in a diversity suit, a federal court sitting in New Jersey is bound to apply

Chapter 131 of the Laws of 1945.* This issue turns upon whether the right to security for expenses of litigation bestowed upon the corporate defendant by this statute is "substantive" or "procedural", as these terms are defined in *Guaranty Trust Company* v. *York*, 326 U. S. 99, 109, i. e., does the application of this statute substantially affect the result of the litigation?

In *Boyd* v. *Bell*, 64 F. Supp. 22 (S. D. N. Y.), Judge Bright pointed out the obvious fact that the granting or withholding of security does not affect the outcome of the main litigation brought by a plaintiff stockholder on behalf of the corporation against the individual wrongdoing defendants.** To meet this point—and also the point respecting the appealability of the order refusing security—

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* "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive."

** In the latter stages of this same litigation, Judge Frank expressly and Judges Chase and Clark impliedly, agreed with Judge Bright's conclusion. *Aspinook Corp.* v. *Bright*, 165 F. 2d 294 (C. C. A. 2d).

respondent has contended, and the Court of Appeals has held, that the controversy regarding security is a cause of action separate from the main action.* This exercise of verbal logic does not, however, meet Judge Bright's objection. If we say that there are two litigations, the main litigation and the bond litigation, these litigations are nevertheless connected;** and the posting of security in the bond litigation still remains a procedural condition precedent to the continuance of the main litigation.*** So we are just where we started.

Accordingly, the respondent corporation if it adheres to the formula laid down in *Guaranty Trust Co.* v. *York*, is driven to the argument that an order requiring the posting of a bond "significantly affects" the main litigation in the sense that, unless the order is complied with, the main litigation ends. If this is what the court meant in *Guaranty Trust Co.* v. *York*, then any procedural device, however fantastic, which puts a quietus upon a lawsuit is, within the *York* definition, "substantive" and binding upon the

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* "Now it must be conceded in the case at bar that the right to security given to Beneficial by R. S. 14:3-15 is not a part of and is legally unconnected with the causes of action asserted by the plaintiff against the individual defendants for the benefit of the corporate defendants. It is as if a [fol. 53] little cause of action had been engrafted on the body of the main suit for the benefit of the corporation" (R. 50).

** "There can be no doubt, however, that the New Jersey statute imposes a limitation on the right of the plaintiff to maintain her suit. R. S. 14:3-15 is a kind of legal hybrid, functioning both by way of limitation and creation" (R. 50-51).

*** Even in the bond litigation, viewed as a separate litigation, the posting of a bond is probably procedual. The only escape from this conclusion is to argue, as does respondent, that no final judgment may be entered against plaintiff in excess of the amount of the bond. The statute is silent upon this point. In the absence of construction by a New Jersey court we submit that this court should hesitate to say that final relief is limited by the amount of the bond fixed in an early stage of the litigation on the basis of biased and conflicting affidavits.

federal courts. The more drastic the limitation on plaintiff's right to proceed, the more "substantive" it becomes—with the result that federal courts in diversity cases can govern their own procedure only in unimportant particulars. We respectfully submit that the *York* case stands for no such doctrine.

In the *York* case this Court specifically approved and retained the doctrine expounded in *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491; *Henrietta Mills* v. *Rutherford Co.*, 281 U. S. 121; and *Kelleam* v. *Maryland Casualty Co.*, 312 U. S. 377 (a decision rendered after the *Erie R. R.* v. *Tompkins*, 304 U. S. 641), that federal courts will enforce equitable rights newly created by a state but will not give equitable remedies unknown to their own system of jurisprudence. The adoption of the Federal Rules of Civil Procedure and the recent repeal of the Conformity Act have given congressional support to this policy. It is clear, therefore, that a field exists, denominated "procedural", where the state may validly legislate for its own courts but may not legislate for federal courts. The sole question is as to the content of that field. If respondent's contention be accepted, it has no significant content.

It is true that where a state may constitutionally deny any remedy for a pre-existing right in its own courts, the federal courts, sitting in diversity cases, are likewise closed. *Angel* v. *Bullington*, 330 U. S. 183. Accordingly, had New Jersey in terms abolished stockholder actions, it would have brought itself within the *Angel* doctrine; but such a statute would have raised constitutional problems even more serious than are here presented. By adopting a procedural device which denies a remedy in some but not all cases, it may have reduced the constitutional risk so far as its own courts are concerned; but by adopting that device it has incurred

a different risk, the risk that federal courts will characterize the device as procedural—which it is—and refuse to be bound by it.

The question here presented is not one of judicial as against legislative powers. It concerns the balance of power between the states and the distribution of power between the states and the nation. Within the state itself the legislature has great latitude in experimentation. Within broad limits the remedy of a citizen against ill-judged legislation lies at the polls and not in the courts. But this caveat has little force when the conflict arises not within the state but between different states or sections. When such a sectional clash of interests results in litigation, Congress has afforded an impartial tribunal for the litigants and has dictated the procedure in that tribunal. To rob the term "procedural" of all significant content is to thwart the very purpose of the diversity jurisdiction.

To be specific: It is a matter of common knowledge that the financing and direction of national corporations are concentrated in a few states, where management constitutes a powerful interest economically and politically. A citizen of New York* sells stock in a national corporation to a citizen of Texas and then proceeds to loot the corporation. The citizen of Texas resorts to a national court in the State of New York. He is there confronted with a procedural device, enacted not by Congress but by the New York Legislature, which, responding to the dominant local interest, seeks to make his action as difficult as possible. Upon protesting, he is solemnly told that this device, though procedural in the classic sense, is binding on the federal courts; that whether procedural or substantive, it represents an import-

* Section 61-b of the New York General Corporation Law is the prototype of similar legislation in New Jersey and Pennsylvania.

ant public policy of New York (Resp. Brief, p. 33); and that if he does not like it he can appeal to the New York Legislature (Resp. Brief, p. 42).

A short and, we believe, a proper answer, rooted in constitutional history, is that New York can clog the remedies of its own citizens in its own courts, but cannot regulate the traditional remedies given by federal courts to citizens of other states.

Respectfully submitted,

LEWIS M. DABNEY, JR.,
Amicus Curiae.